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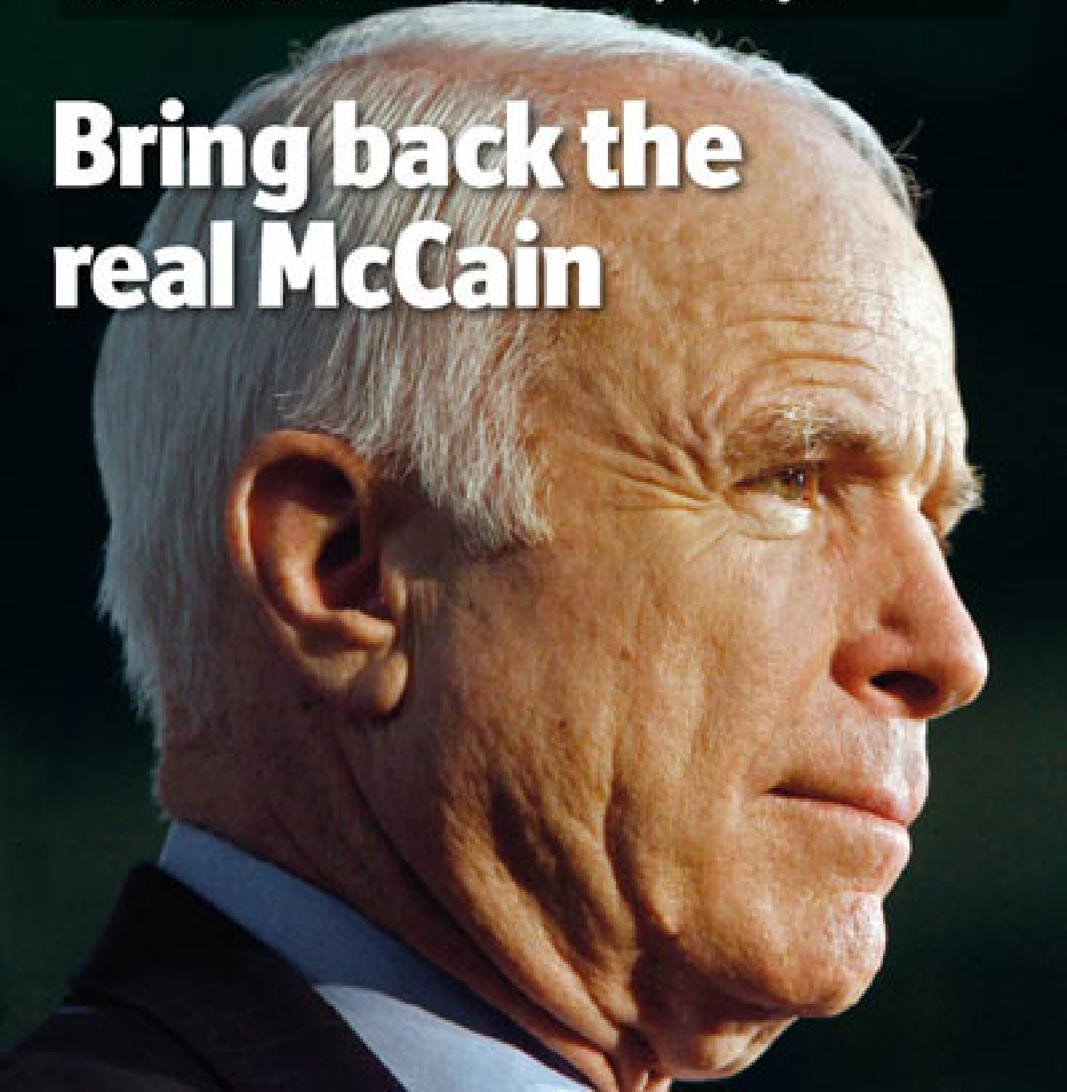
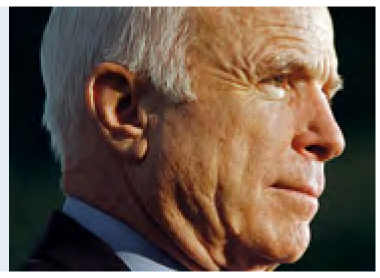


Print Edition August 30th 2008

Bring back the real McCain

The Republican candidate is fighting hard, but he needs to do more to separate himself from George Bush: leader



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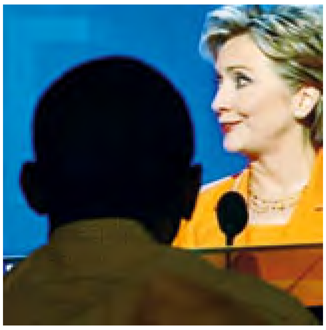
Aug 28th 2008
From The Economist print edition

Reuters



The **Democrats** gathered for their convention in Denver, which was dominated by the reluctance of Hillary Clinton supporters to throw their weight behind Barack Obama. Mrs Clinton (and husband Bill) backed Mr Obama unequivocally, and in a dramatic gesture of support the narrow loser of the primary elections moved to suspend the floor count of delegates and confirm Mr Obama's nomination by acclamation. The candidate himself prepared to deliver his acceptance speech in front of a huge stadium crowd. See article

Earlier, Mr Obama picked **Joe Biden** as his choice for vice-president. Mr Biden has represented Delaware in the Senate since 1973 and is currently chairman of the Foreign Relations Committee. See article

The Census Bureau reported that 45.7m people were without **health insurance** in the United States in 2007. This was down from 47m the previous year, but higher than in 2000, when 38.4m had no health cover. America's **poverty** rate stood at 12.5%; Mississippi was the poorest state, with more than a fifth of its residents under the poverty line. See article

Law of the jungle

Peru's Congress voted to scrap two decrees that made it easier for outsiders to buy land in the country's Amazon jungle after a fortnight of protests by Amazonian Indian groups. See article

Honduras, traditionally an ally of the United States, joined the Bolivarian Alternative for the Americas, an anti-American pact led by Venezuela's Hugo Chávez. Its other members are Cuba, Bolivia, Nicaragua and Dominica.

In **Cuba**, Gorki Aguila, a punk-rock musician, was arrested as he was preparing to record an album, reportedly on a charge of "social dangerousness". His band, Porno Para Ricardo, often writes lyrics that are critical of the communist regime.

Divided government

Zimbabwe's opposition Movement for Democratic Change, which has held most seats in Parliament since an election in March, managed to elect its nominee as speaker. This gives the MDC the main say in setting the legislative agenda, at least in principle. President Robert Mugabe still holds executive power, despite negotiations, recently stalled, over sharing power. See article

Somali Islamists said they had captured Kismayu, the southernmost port in seemingly ungovernable **Somalia**.

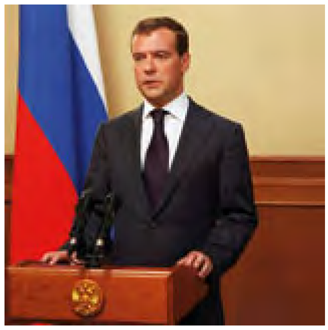
A **Sudanese** commercial airliner was hijacked after taking off from the Darfuri town of Nyala bound for Khartoum, Sudan's capital. The hijackers diverted the plane to Libya, where they surrendered after freeing the passengers. Darfur's main rebel groups denied the Sudanese government's claims that they were responsible.

Moscow calls the shots

EPA

Russia's president, Dmitry Medvedev, gave formal recognition to **Georgia's** breakaway enclaves of Abkhazia and South Ossetia as independent countries. The Russians were also keeping troops inside Georgia proper. Mr Medvedev

insisted that Russia had invaded Georgia only to protect lives and uphold peace. He also said that Russia was not afraid of a new cold war. See article



Western countries condemned Russia's unilateral recognition of the two Georgian enclaves. The **European Union** called an emergency summit to reconsider its relations with Russia. George Bush demanded that Russia reverse its "irresponsible decision". See article

Eurostat, the EU's statistical office, released population forecasts suggesting that by 2060 **Britain** will have the biggest population among current EU members. The EU's total population is expected to stand at 506m in 2060. See article

Bertrand Delanoë, the popular mayor of Paris, confirmed that he would stand for the leadership of **France's** Socialist Party in October. He will be a strong challenger to Ségolène Royal, the favourite for the job.

Power vacuum

The Pakistan Muslim League (N), or PML (N), withdrew its support for **Pakistan's** governing coalition. It was protesting at the failure of the coalition leader, the Pakistan People's Party (PPP), to reinstate all the judges sacked last year by Pervez Musharraf, who recently resigned as president. The PML (N) also objects to the decision of Asif Zardari, the PPP's leader and widower of Benazir Bhutto, a former prime minister, to stand in the indirect election to choose Mr Musharraf's successor, to be held on September 6th. See article

Following further huge pro-independence protests in Srinagar, capital of **Indian-administered Kashmir**, the government imposed an indefinite curfew and arrested a number of separatist leaders. At least four people died when the security forces fired on demonstrators trying to break the curfew.

At least 11 people died in clashes between Christians and Hindus in **India's eastern state of Orissa**. The violence started with the killing of a Hindu leader, blamed by the police not on Christians but on Maoist rebels.

The United Nations representative in **Afghanistan** said the organisation had credible information that 90 civilians, including 60 children, had been killed in an American bombing raid near the western city of Herat on August 21st. American officials disputed the claim. See article

Anwar Ibrahim, leader of **Malaysia's** opposition, easily won a by-election to return to parliament. Mr Anwar claimed he would soon be in a position to overturn the government's parliamentary majority. See article

Protesters in Bangkok staged a sit-in in the main government compound, demanding the resignation of **Thailand's** prime minister, Samak Sundaravej. It is the latest stand-off in the three-year confrontation between supporters and opponents of Thaksin Shinawatra, the former prime minister, now in exile in Britain. See article

EPA

Ibrahim Gambari, a UN envoy, left **Myanmar** after a six-day visit intended to promote political reconciliation. But he failed to see either the junta leader, Than Shwe, or the detained opposition leader, Aung San Suu Kyi. According to some reports, Miss Suu Kyi has started a hunger strike. See article

The **Beijing Olympics** ended with a spectacular closing ceremony, in which the Olympic flag was passed to the mayor of London, host city to the next games in 2012. This year China for the first time won more gold medals than any other country. See article

Business this week

Aug 28th 2008
From The Economist print edition

America’s Federal Deposit Insurance Corporation reported that 117 banks were on its “problem list” in the second quarter, 30% more than in the first quarter and the most for five years. The total assets of the **problem banks** increased from $26 billion to $78 billion ($32 billion of which was accounted for by IndyMac, a Californian bank that failed in July). Sheila Bair, the head of the FDIC, forecast that the banking crisis would worsen and more banks would join the list. See article

Securities regulators began a process that could see all American companies switch to international **accounting standards** by 2016. From 2010 the largest will be allowed to ditch GAAP, for decades the beancounters’ gold standard but now seen as cumbersome.

Denmark’s central bank led an effort to rescue **Roskilde Bank** that takes the troubled lender into public ownership. With the economy falling into recession, Danish property prices have tumbled.

Mortgage relief

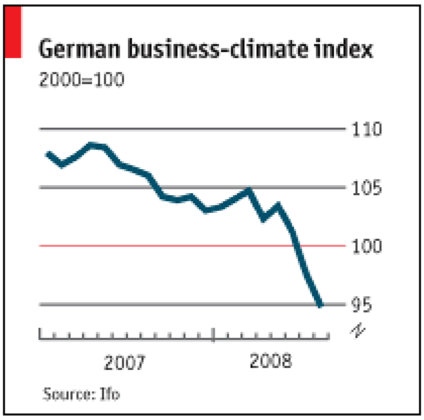
Fannie Mae and **Freddie Mac** enjoyed a respite, with the share prices of both government-backed mortgage giants making huge gains after brokers pointed out that they had enough capital to avoid a government bail-out for some months. Fannie Mae shook up its management team, replacing three executives, including its chief financial officer and chief risk officer. See article

Indian companies announced more big foreign acquisitions. **Infosys Technologies**, which handles software services for other firms, launched a $753m bid for Britain’s **Axon** (which saw its share price surge above Infosys’s offer price on rumours of a counter-bid). And India’s state-run **Oil and Natural Gas Corporation** agreed to buy **Imperial Energy**, an oil-exploration company working in Russia, for $2.6 billion. ONGC is expected to sell a stake in Imperial to a Russian energy company, such as Rosneft.

Southwest Airlines became the latest American carrier to reduce its capacity because of high fuel costs. It will scrap almost 200 flights from its schedule, or around 6% of its departures, starting next year. Southwest had hoped to avoid making cuts, as it has outperformed its rivals this year and turned a profit in the second quarter.

Low Germany

The **business climate** in Germany is at its lowest level for three years, according to one index compiled by Ifo, a think-tank. A separate survey found that German consumer sentiment is at a five-year low. Fears of a recession in Germany were also stoked by confirmation that the economy contracted by 0.5% in the second quarter compared with the previous quarter.



Precision Drilling Trust, Canada’s biggest operator of oil and gas rigs, agreed to buy **Grey Wolf**, a rival based in Houston, for $2 billion. Both companies specialise in drilling on land. More energy rigs are operating in the United States than at any time since 1985, according to data compiled by Baker Hughes, an oilfield-services company.

An appeals court upheld a ruling that the federal government should pay $1 billion to a dozen **oil companies** that received leases to exploit California’s continental shelf, but were unable to drill there because of subsequent coastal-protection laws. A debate is raging in America over whether to open up more areas to offshore drilling.

At least surf's up

Quiksilver, a Californian maker of sports apparel, received an offer for its **Rossignol** division, which makes ski equipment among other things, from a group headed by Bruno Cercley, Rossignol's former boss. Quiksilver bought Rossignol in 2005 for $561m, but a poor ski season this year and the economic slowdown have proved a drag. Mr Cercley is offering $148m for the business.

Rio Tinto reported half-yearly net profit of $6.9 billion, an increase of 55% on the same period a year ago. The Anglo-Australian mining company is being pursued in a hostile bid by its rival, **BHP Billiton**, which reiterated that it thinks a deal makes sense. Investors, however, are concerned about falling commodity prices and the chances of a cool reception to a merger from regulators.

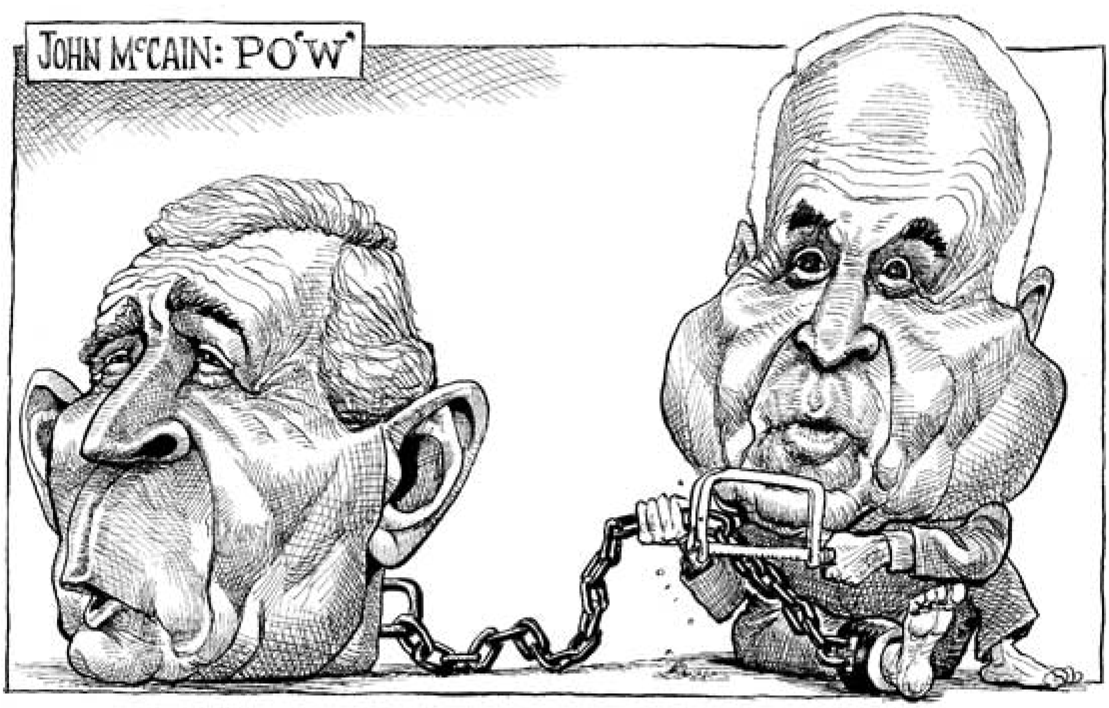
Toyota cuts its global sales forecast for next year. The carmaker cited high petrol prices in the United States, its biggest market.

ConocoPhillips decided to sell its remaining petrol stations, following other oil companies in offloading low-margin retail operations to focus on exploration, refining and trading. Conoco's 76 and Phillips 66 branded petrol stations are familiar to American motorists and will be kept by the new owner, which plans to introduce a range of new services for drivers.

KAL's cartoon

Aug 28th 2008
From The Economist print edition

Illustration by KAL



Economist.com OPINION LEADERS

The presidential race

Bring back the real McCain

Aug 28th 2008
From The Economist print edition

The Republican candidate is fighting hard, but he needs to do more to separate himself from George Bush

EPA

AMERICA'S Republicans head for the Twin Cities of Minneapolis and St Paul this weekend in a position that few of them could have imagined even a month ago. Although voters claim that they prefer Democrats to the representatives of the Grand Old Party by a solid margin of more than ten percentage points, and though it seems that there is hardly a soul in the nation who thinks things are on the right track, by the start of the conventions John McCain was more or less level with Barack Obama in the opinion polls. There is a genuine chance that, even after almost eight years of George Bush's calamitous presidency, the voters may actually opt for another stint of Republican administration. In part this reflects the weaknesses that lie alongside the charismatic skills paraded by Mr Obama in Denver this week: his inexperience, especially in foreign affairs, at a time when the world looks more and more complex and troubling, and a certain cerebral aloofness that seems to make it hard for him to connect with Middle America. But a big part of the reason is that, in Mr McCain (see article), the Republicans have rallied round the only candidate who could have saved them.

Mr McCain's fierce patriotism appeals to the security-conscious, while his long history of opposition to the shortcomings of his own party (its hostility to immigrants and its insouciance in the face of climate change, to take two examples) gives him more pull with independent voters than any other Republican could have offered. *The Economist* particularly likes him for his robust commitment to free trade, and his firmness in the face of American losses in Iraq. Above all, he has often displayed a degree of political courage that Mr Obama has never shown. This at least offers the chance that, as president, Mr McCain would be able to make bipartisan deals with a Congress that looks certain to be heavily Democratic.

But if he is to do the astonishing and win, against the odds and despite the fact that Democratic voters are more fired up than the disconsolate Republicans, Mr McCain still has to surmount some sizeable obstacles. One problem is something that he, like Mr Obama, can do nothing about: his age. At 72, he would be the oldest president ever inaugurated, apart from Ronald Reagan in his second term. But voters can at least be reassured by the cracking pace the candidate has set on the campaign trail. His choice of vice-president, expected on August 29th, will be crucial too, playing a bigger part in the voters' ultimate decision than Mr Obama's selection of Joe Biden as his running-mate on the eve of his own convention. Another obstacle is Mr McCain's legendarily volcanic temper, which the candidate himself admits to: a serious flaw in a man vying to be commander-in-chief. Still, plenty of other politicians share this trait—

Bill Clinton was another serial erupter—and it can at least be said that Mr McCain has kept himself entirely under control during the campaign.

A third obstacle is that many Americans see him as a warmonger, a man who would be happy to bomb Iran if that is the only way to prevent it from acquiring nuclear weapons, who is more than ready to confront Russia, and who supported toppling Saddam Hussein before George Bush was elected and New York and Washington were attacked. This fear is surely overdone: even though Mr McCain is presumably more minded than Mr Obama to attack Iran, neither the joint chiefs of staff nor most of his advisers think that is a good idea. But it is not a completely unreasonable worry. Mr McCain needs to find ways of correcting this perception, rather than making jokes about bombing.

Another broad concern, too, needs scotching at the Republican convention and during the election campaign that will follow it. In his desire to get elected, Mr McCain has been prepared to abandon some of the core beliefs that made him so attractive. This is not so much true of foreign policy (Mr McCain has long been a hawk, since the successful NATO campaigns in Bosnia and Kosovo). But even here, he used to talk much more about multilateralism than he does now. On the campaign trail, Mr McCain has tended to stress the more hawkish side of his nature, for instance by promoting his idea for a "league of democracies" that risks being needlessly divisive.

Too polite to the right

But it is on domestic policy that Mr McCain has tacked to the right more disquietingly. Doubtless he feels he needs to shore up his support among the conservatives who mistrust him. But the result is that he could easily alienate the independent supporters who are his great strength. Mr Obama will sensibly hope to woo them away.

Mr McCain used to be a passionate believer in limited government and sound public finances; a man with some distaste for conservative Republicanism and its obsession with reproductive matters. On the stump, though, he has offered big tax cuts for business and the rich that he is unable to pay for, and he is much more polite to the religious right, whom he once called "agents of intolerance". He has engaged in pretty naked populism, too, for instance in calling for a "gas-tax holiday". If this is all just a gimmick to keep his party's right wing happy, it may disappear again. But that is quite a gamble to take.

Two months remain before the election, more than enough time for Mr McCain to allay some of these worries. He needs to spend less time reassuring evangelicals that he agrees with them about abortion and gay marriage, and more time having another look at his tax plans. The old John McCain attacked Mr Bush for his tax cuts, which he said were unaffordable. The new John McCain not only wants to make the Bush tax cuts permanent, but wants to add to them by virtually eliminating estate tax (something that would benefit a tiny number of very rich families, like his own). He also proposes to slash corporation tax. People on middle incomes would see little benefit. Independent analysts agree that Mr McCain's plans would increase an already huge deficit.

Hawkish foreign policy, irresponsible tax cuts, more talk about religion and abortion: all this sounds too much like Bush Three, the label the Democrats are trying to hang around the Republican's neck. We preferred McCain One.

Iraq

Leave as soon as you sensibly can

Aug 28th 2008
From The Economist print edition

Iraqis naturally want their country back, and should have it as soon as they think they are ready

AFP

IT IS a cheering new sign of confidence that Iraq's prime minister, Nuri al-Maliki, is now demanding an agreement with the United States that would require all American troops to leave the country by the end of 2011. That is a bit later than Barack Obama's proposal to bring them home by May 2010 and a bit earlier than John McCain's more tentative hopes for a withdrawal by 2013. But it suggests that the spectrum of serious possibilities is narrowing. It shows that Iraqis are beginning to believe in their ability to stand on their own feet. And it flashes a ray of light at the end of Iraq's still dismally dark tunnel.

Iraq is far less horrible than it was two years ago. The Americans' surge of extra troops, a series of ceasefires and deals with once hostile Sunni tribes in the west and with Shia militias in the slums of Baghdad, the windfall of extra cash from oil exports: all these things have given the country fresh hope.

But it is still a bloody mess. Some 4m Iraqis have fled the country or remain displaced from their homes within it. Hundreds are still being killed every month. A vicious insurgency persists, especially in the mixed-sect provinces north of Baghdad and around the northern city of Mosul. No solution to the rancorous dispute over the now mainly Kurdish-run city of Kirkuk is in sight. The Iraqis have yet to decide how to manage the oil and dish out its revenue. Above all, the newly dominant Shia Arabs have yet fully to accommodate the aggrieved Sunnis, who ruled Iraq under Saddam Hussein and since its inception as an independent country nearly 80 years ago.

So Mr Maliki's optimism must be tempered with many a caveat. His new insistence on a strict timetable is partly intended to burnish a nationalist image in the face of his populist Shia rival, Muqtada al-Sadr, who has long demanded the immediate removal of the Americans. Though the Sadrists may not stand in the upcoming provincial elections as a party, individuals known as disciples of Mr Sadr are likely to do well. And Mr Maliki knows that what is agreed upon with an outgoing American administration may have to be adjusted by a new one; deadlines will be subject to shifting circumstances.

In any event, he still has a lot to do to keep Iraq heading in the right direction—and give it a chance of meeting a tighter deadline for an American exit. For one thing, he should strive far harder to bring into a new national-security structure the Sunni fighters known as "Sons of Iraq", whom the Americans have been paying to fend off al-Qaeda and other insurgents in Sunni areas of Baghdad and in western Iraq. Instead, there have been alarming reports that Mr Maliki's men have been seeking to arrest several hundred of the leading "Sons", thereby risking a deeper rupture between Iraq's two main Arab communities. It is also vital that Mr Maliki overcomes recent glitches to ensure that provincial elections, due late this year or early next, do take place, so that the Sunnis who had previously boycotted them are

re-empowered. Parliamentary elections should follow at the end of next year. It is by no means certain that Mr Maliki will keep his job as prime minister.

Don’t be boxed in

Moreover, any Iraqi leader will still need the flexibility to call on foreign allies’ military muscle. Iraq’s army has improved but cannot yet defeat the insurgency on its own. If Mr Obama wins the presidency, he may prove wisely more elastic in his interpretation of an American withdrawal; Mr McCain still rightly refuses to be hemmed in by deadlines. If Iraq’s leader tells the Americans to go forthwith, they must do so. But that is unlikely to happen in a hurry. Whatever the arguments over the American-led invasion, it remains the case that a hectic exit would be bad for everyone, especially the Iraqis.

Economist.com OPINION LEADERS

Russia and Georgia

South Ossetia is not Kosovo

Aug 28th 2008
From The Economist print edition

Russia's recognition of Abkhazia and South Ossetia cannot be justified by a bogus comparison to Kosovo

WITH a flourish, Russia this week recognised the "independence" of Abkhazia and South Ossetia, the enclaves that gave it a *casus belli* for its war on Georgia (see article). The Abkhaz and Ossetians celebrated their reward for living under Russian protection for 15 years. The Russians saw it as a logical outcome of their victory, a further stage in their confrontation with the West—and a copy of what happened in Kosovo. As Russia's president, Dmitry Medvedev, argued, "you cannot have one rule for some and another rule for others."

Yet the West is right to respond firmly to Russia's new belligerence by refusing to recognise the new states. Never mind that Russia is itself being incoherent in continuing to insist that Kosovo's independence from Serbia is still illegal (a stance driven in part by its wish to avoid setting a precedent for Chechnya or other restive republics within Russia). Mr Medvedev's assertion of a parallel between Kosovo and South Ossetia is almost entirely bogus.

This is not to deny the superficial similarities that the West would do well to accept. NATO's air war on Kosovo and Serbia in 1999 was, like the Iraq war in 2003, conducted without the legal approval of the United Nations. Both wars were aimed in part at regime change. Last February's recognition by many Western countries of Kosovo's independence from Serbia again lacked formal UN blessing (thanks to Russia's threatened veto). All this made it inevitable that Kosovo, like Iraq, would be cited as justification for other adventures. The West knew that Kosovo's independence, in particular, risked becoming an excuse for Russian recognition of Abkhazia and South Ossetia.

Yet this is where the parallels run out. In Georgia's enclaves, Russian forces have acted as self-interested troublemakers, not as neutral peacekeepers. Serbia's Slobodan Milosevic long oppressed the Kosovo Albanians, as well as perpetrating war and ethnic cleansing right across former Yugoslavia. But it was the Georgians who ended up as the bigger victims of ethnic cleansing in Abkhazia in the 1990s, and have been again in South Ossetia in the past three weeks. Unlike Milosevic, Georgia's Mikheil Saakashvili is a democratically elected president who will surely be held to account by voters for his impetuous decision to invade South Ossetia on August 7th.

Motive provides an even clearer difference. Throughout the 1990s the Americans and Europeans were extremely reluctant to get involved in the Balkans. After Milosevic's withdrawal from Kosovo in 1999, the main role of the UN and NATO forces in the province was to protect the Serb minority and Serb religious sites. The Western powers devoted years to negotiations over the province's future, culminating in UN-led talks under Martti Ahtisaari, a former Finnish president. Only when these failed, again thanks mainly to Russian intransigence, did Kosovo's unilateral independence become inevitable.

In total contrast, Russia has nakedly pursued its own interests in the Caucasus. It did its utmost to provoke Mr Saakashvili into a fight. Its “peacekeepers” have made no pretence of protecting minorities in Abkhazia and South Ossetia. It has not even tried to promote serious negotiations over the territories’ future. Instead, it has steadily cemented their links with Russia, building up military facilities and giving the local people Russian passports (a transparent ploy to justify a later purported need to “protect” Russian citizens). Although Mr Saakashvili took the catastrophic decision to send in the Georgian army, resulting in many civilian deaths, no evidence has been offered by the Russians to support their wild claims of genocide or ethnic cleansing.

Peacekeepers or piece-keepers?

The difference between Kosovo and South Ossetia has been starker still in the war’s aftermath. In 1999 the Western powers went in as a last resort and quickly internationalised the issue, bringing in the UN and international peacekeepers. Eight years of patient diplomacy preceded Kosovo’s independence. The Russians invaded Georgia in a fever of war enthusiasm; have refused to pull out and rejected attempts to internationalise the dispute; and have now recognised the enclaves’ independence less than three weeks after the war began.

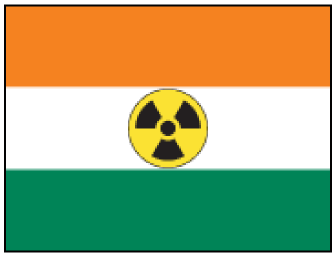
In principle, sub-national states should sometimes be able to secede, but South Ossetia and Abkhazia clearly do not qualify. Neither enclave has properly consulted its people, including huge numbers of Georgian refugees. Nor has there been a long, hard effort to find a negotiated settlement. Mr Saakashvili should stop promising to regain control of the enclaves, and the West should insist on the case for international peacekeepers. But Russia’s aggression in Georgia must not be rewarded by conceding the enclaves’ independence. That really could set a dangerous precedent, in Ukraine, Moldova and—not least—inside Russia itself.

America’s nuclear deal with India

Time to decide

Aug 28th 2008
From The Economist print edition

There should be no exemption for India from the world’s nuclear rules



IN A dangerous and unstable world, isn’t cementing friendship with an up-and-coming power such as India worth breaking a few rules for? That is the reasoning behind the Bush administration’s championing of a controversial civilian nuclear deal with India, which George Bush and India’s Manmohan Singh struck in 2005. To take effect it now needs only an India-sized hole to be punched next week in the global rules on nuclear trade and then a final nod from America’s Congress.

The trade restrictions of the 45-nation Nuclear Suppliers Group (NSG) are supposed to apply to countries that, like India, have built bombs rather than sign up to the Nuclear Non-Proliferation Treaty (NPT). In return for exempting India from these restrictions, the Bush administration hopes India will be a bulwark against China. Doubters in Congress and opponents abroad have also been lectured on the supposed benefits of bringing India into the “non-proliferation mainstream”.

The deal is being mis-sold on both counts. Some see it as a Nixon-to-China moment: Nixon opened diplomatic relations with Communist China to balance the Soviet Union; doing nuclear favours for India now will help balance a rising China. But India has no intention of picking America’s fights with China. The pending deal has, it is true, persuaded India to back without enthusiasm demands at the International Atomic Energy Agency (IAEA), the UN’s nuclear guardian, for Iran to suspend suspect nuclear work. But Indian contacts with Iran, and other unsavoury regimes, remain unhelpfully close. The high-water mark of India’s helpfulness, such as it was, is passing.

As for India contributing to non-proliferation, the opposite is happening: the anti-proliferation consensus is being ruptured. For India, an exemption from NSG restrictions on nuclear trade would be an answer to its nuclear prayers: but its military ones, not its civilian ones. India is short of usable uranium. If it could buy foreign fuel for its civilian reactors, it could devote more of the stuff it makes at home to bomb-building. That alone ought to give pause to any government that takes seriously its obligation under the NPT’s Article 1: not to help others in any way with weapons-building.

Unlike members of the NSG, India has not only failed to sign the NPT, it has not signed the Comprehensive Test-Ban Treaty either. It claims to support a treaty to cut off the production of fissile material for bombs, knowing full well that negotiations on that treaty have been stuck for years. And unlike America, Russia, Britain, France and China, the five official nuclear powers, it refuses to cap uranium and plutonium production for military uses. India has agreed to put more civilian reactors under IAEA safeguards—but on the unilateral insistence it can take “special measures” (like tossing inspectors out) if its other demands are not met. These include the uninterrupted supply of foreign uranium fuel and help in building up a strategic fuel reserve.

India’s purpose is clear. It wants to leave itself the option of more bomb tests in future, while being able to ride out any sanctions—including from America, whose laws would require them—that would follow. Congress may not have noticed, but American officials have been coaching India in avoidance tactics: buy your uranium fuel from others, not us, they suggest, and you’re in the clear.

Just say no

The NSG was set up precisely to stop countries doing what India did to get a start in the bomb business: abusing technology and skills provided for civilian purposes. The group’s ban on trade with countries that break the non-proliferation rules has been the chief underpinning of the NPT regime. Waive the ban and the NSG will have little point. It should refuse to make an exception for India. And so should America’s Congress.

Economist.com OPINION LEADERS

Fannie Mae and Freddie Mac

Fire the bazooka

Aug 28th 2008
From The Economist print edition

It is time to nationalise America's mortgage giants—and then to dismantle them

Bloomberg News

AS HANK PAULSON, America's treasury secretary, is learning, the trouble with having a bazooka in your pocket is that you may have to use it. He used the bazooka as an analogy to describe the massive firepower the Treasury could deploy, if necessary, in support of Fannie Mae and Freddie Mac, America's beleaguered mortgage giants, thanks to a new law signed in July. Just putting the money at their disposal, he argued, could insure it would never be used. Now his bluff is being called and the future of Fannie and Freddie is once again hanging like a thunder cloud over American finance. It is time for Mr Paulson to show what he, and his bazooka, are made of.

None of his options is enviable—though choosing the right one could crown a long career in finance. Fannie and Freddie have become indispensable to the housing market; they account for up to nine out of ten secondary mortgages in America, and owe or guarantee about $5.3 trillion. Meanwhile, hundreds of America's banks rely on their shares to shore up their capital (see article) and foreign central banks are big holders of their bonds. Yet the two firms are woefully short of capital and in need of support. Whatever Mr Paulson does to address this, there will be collateral damage.

Nothing will come of nothing

This week the shares of Fannie and Freddie rose slightly (they are still down 85% or so this year) on hopes that Mr Paulson would take the easy option and sit tight. It must be tempting. There has been a slight slowing in the pace of house-price declines. Fannie and Freddie found willing buyers in debt sales on August 27th. Both firms are profiting handsomely from their new investments—though losing far more money on the old ones. Politically, laissez-faire is seductive. Congress, which has feasted on the lobbying largesse of Fannie and Freddie for decades, has a vested interest in the status quo.

Yet the one thing Mr Paulson must not do is sit on his hands. By allowing the Treasury to make loans to, or invest in, the companies, Congress made explicit what had always been tacitly understood: that it stood four-square behind the two agencies, even though they have private shareholders and managers paid like Wall Street barons. That is capitalism at its worst: it means shareholders and executives reap the profits, but the taxpayer bears the losses. It is also risky. Between them, the firms have more than $200 billion of debt to roll over in the next month, and the markets are queasy. The collapse of just one bond auction could send shock waves around the world.

An alternative would be for the Treasury to throw Fannie and Freddie a lifeline, perhaps as much as $25

billion-30 billion in new capital. But under the new law, it is not clear that the government would have the right to oust the managers and punish the shareholders. That leaves the Treasury with the unpalatable option of rewarding the institutions for bad behaviour. Not only would this throw good money after bad. It would encourage executives to “gamble for resurrection”—to take big mortgage risks in a desperate attempt to make profits.

All of which argues in favour of the bazooka option, nationalisation, as the only one that is fair to the taxpayer. Once the two firms’ capital sinks below a certain threshold (which could easily happen with a nudge from Mr Paulson), receivership—as a prelude to nationalisation—is allowed by law. In a stroke, that would lower the twins’ funding costs and, hence, mortgage rates, and show commitment to the stability of the mortgage market. It would, of course, technically add huge liabilities to the government’s balance sheet; but these would be offset by mortgage assets that are almost as large.

Nationalisation need not be the end of the story. The giants’ assets should be liquidated over time, or the entities broken up and privatised. The companies’ size and strange structure carry a big cost for American finance. Backed by cheap government funding, their bosses have speculated with the gusto of hedge-fund managers—and lost, time and again. The two Leviathans have squeezed private firms into the riskiest ends of the mortgage market, such as subprime lending. They have not brought sharply lower mortgage rates to America. Europe, where mortgage markets are fully private, is no worse-off.

Politicians, especially the Democrats, will rush to their defence. After all, the two firms have big influence. That is the strongest reason to move quickly—especially now they are so nearly insolvent. Fannie and Freddie have outlived their usefulness and should be dismantled. Doing so would be a great legacy to leave to American finance. But as the November elections approach, Mr Paulson’s time is running out.

Economist.com OPINION LETTERS

On Russia and Georgia, risk managers, English spelling

Aug 28th 2008
From The Economist print edition

The conflict in Georgia

SIR – Russia's conduct regarding Georgia may be high-handed and brutal ("Russia resurgent", August 16th), but the Georgian government behaved irresponsibly in the first place by assaulting South Ossetia against the advice of America and others. Georgia's recklessness would be simply intolerable if it were a NATO member. Each nation in NATO knows it has a potential finger on the trigger by provoking any act on it that could draw other members into a war.

Frederick Trapnell
Los Altos, California

SIR – Georgia and Ukraine have belonged to Russia's "backyard" for centuries and the West is deluded if it thinks Russia will tolerate them joining NATO or the European Union. This is especially true for Ukraine. The Crimean peninsula and the eastern part of that country are mostly inhabited by Russians. The region of Kiev is the cradle of Russian civilisation, the Kievskaya Rus. Only one region of Ukraine, Galicia in the extreme west, has Western cultural and religious traditions as it used to be part of the Austro-Hungarian empire.

It would be an even bigger and dangerous delusion for the West to expect Russia to abandon Ukraine to Western influence without Russia reacting vigorously, perhaps with a major war.

Frits Gorlé
Emeritus professor of law and Slavonics
Ghent, Belgium

SIR – I was disappointed that you didn't draw the obvious parallel between Russia's invasion of Georgia and America's invasion of Iraq. It was a lust for oil that drove the actions of both countries, though they gave altruistic, and unfounded, reasons for their wars: the destruction of Saddam Hussein's WMD in Iraq and Mikheil Saakashvili's alleged "genocide" in South Ossetia. This makes George Bush's rather slow declaration that it was unacceptable for Russia to invade a sovereign state hypocritical. After all, a pupil was just following an example set by his mentor. Mr Bush should instead have extended his compliments to Vladimir Putin.

Ronald Solberg
Downers Grove, Illinois

SIR – Without in any way accepting Russia's justifications for invading Georgia, the deliberate creation of a crisis applies just as well to the chorus of disinformation in 2003 about the danger Saddam presented, which *The Economist* supported. Just as Russia's plans to enter Georgia long preceded its incursion, Dick Cheney and friends were eager to invade Iraq long before the actual event.

Stephen Murrayo
San Francisco

Risky business

SIR – As a past risk manager in financial services I liked the refreshing honesty of the anonymous person interviewed in your article ("Confessions of a risk manager", August 9th). It seems that even diligent and well-intentioned risk managers are fallible. However, they are asking for trouble when they agree to review on one-hour's notice proposals that a team has been developing for weeks.

Risk managers can't do a proper job if they aren't part of the team that develops the proposal. They are enablers, not gatekeepers: their job is to ensure that each new transaction, product and service is developed with safety as well as profitability in mind. Weaknesses need to be identified early so that, if they can't be corrected, the proposal can be dropped before anyone gets too attached to it.

To be effective, risk managers clearly need different incentives and separate reporting lines than the front office. And, since intimacy discourages impartiality, their approval authorities must exclude proposals they have worked on. Sound risk management depends as much on the way a business is structured and its culture as on the quality of the individuals. And as structure and culture are matters for the board, so are the failures of risk management.

David Howat
London

SIR – If I understand it correctly, the job of a risk manager can be summarised as follows: we bundle up loads of toxic-waste packages and peddle them as AAA investments because the trading desk's insistence on bonuses trumps our sober risk analysis. I look forward to your next article: "How our traders paid back their bonuses and compensated our customers' pillaged pension funds".

Paul Furber
Johannesburg

Language barriers

SIR – I am surprised you think that the suggestion we use variant spellings in English is "too tolerant" ("You write potato, I write ghoughpteighbteau", August 16th). This idea surely resembles a free market in spelling. I for one am glad that the English language does not have a governing body such as the Académie Française. The language is fortunate that no linguistic politburo has ever arisen to bully English-speakers and impose its conformity on us all.

Matt Simon
Boston

SIR – Amending English will be welcomed by children who cannot cope with the spelling of, for example, "cycle", which sounds different when in "bicycle". Such easy corrections were made to the German language a century ago. Perhaps this may explain why the Germans lost two world wars—they were too logical.

Giorgio Perversi
Massimeno, Italy

SIR – You didn't consider French, which has a wealth of silent letters and homonyms and is an inspiration for punsters as well as poets. And the relationship between spelling and pronunciation in Portuguese and the Scandinavian languages is hardly simple. What about Russian, with its Byzantine grammatical case endings mostly sounding the same but spelt differently? The development of English into the world's lingua franca suggests that spelling is not an insuperable barrier.

Jonathan Lynn
Geneva

SIR – I wonder just how many words in the English language have a superfluous u between the letters o and r, as in the word "enamoured". Though I suppose the existence or non-existence of the u is helpful in determining whether the author is American or not.

Robert Carlton
Professor of history
Chaffey College
Rancho Cucamonga, California

SIR – American spelling is not only easier but more phonetic than the British system in large part because of reforms introduced by Theodore Roosevelt. The president issued an executive order in the

summer of 1906 mandating simplified spelling in all government administrative documents.

Tim Nixon
Iola, Wisconsin

SIR – I disagree that double consonants are “bereft of logic”. A little titivation would soon bring honnour (or honner, or onner) and schollar (or scholler or skoller) into line with the double-consonant/short-vowel rule. The difficulty with spelling reform is where does it end? Shudd “about” be “abowt”, and shud “however” be “houever”? If “father” duzn’t need an r, must we keep the one in “farther”, wich only the Scots pronounse differently? If George Bernard Shaw cudn’t get ennywere with refawm, I faw wun giv upp.

Hilary Potts
London

John McCain

No surrender

Aug 28th 2008 | CINCINNATI, OHIO
From The Economist print edition

Illustration by Matt Herring

The gnarled maverick outpolls his party and might even beat Barack Obama. But what sort of president would he be?

ON JULY 16th John McCain addressed the National Association for the Advancement of Coloured People (NAACP). The audience was nearly all black and mostly left-of-centre. Few of them would vote for a Republican in any circumstances, let alone a Republican running against the man who could be America's first black president.

"Let me begin, if I may, with a few words about my opponent," Mr McCain said. "Don't tell him I said this, but he is an impressive fellow in many ways." He said that Barack Obama's success made him proud of his country, since it showed that it was moving away from "the cruel and prideful bigotry" of the past. He then respectfully explained why he disagrees with Mr Obama on certain issues, such as school choice.

It was a shrewd choice of topic. Mr McCain favours giving vouchers that would allow parents whose children are stuck in terrible schools to send them to better ones, whether public, private or parochial, and believes that public money should follow the child, not the diktat of some education bureaucrat. Wherever vouchers have been offered, poor black parents have seized them with both hands. Mr Obama, out of deference to the teachers' unions, opposes school choice—as does most of the NAACP's leadership. So Mr McCain won few converts in the room; but by backing a policy that demonstrably improves the lives of poor blacks and treating a large, quietly hostile black crowd with respect, he reassured the independent voters watching on television that he was a tolerant kind of Republican.

As is his wont, he also slipped in a deft reminder of his own remarkable life story. Recalling the day he heard that Martin Luther King had been murdered, he said he felt "just as everyone else did back home, only perhaps even more uncertain and alarmed for my country in the darkness that was then enclosed around me and my fellow captives."

Biography matters in a presidential election, and this year the candidates offer two quite different kinds of story. Mr Obama's appeal depends on what he symbolises: the uplifting notion that the son of a Kenyan father and a Kansan mother can, through talent and hard work, rise to the highest post in the land. Mr McCain's appeal rests on what he has done.

While Mr Obama was playing hide-and-seek with his fellow six-year-olds, Mr McCain was dodging surface-to-air missiles over North Vietnam. After failing to dodge one of them, he ejected from his plane, broke three limbs and fell into a lake. He was dragged out by a mob, stabbed in the groin and beaten

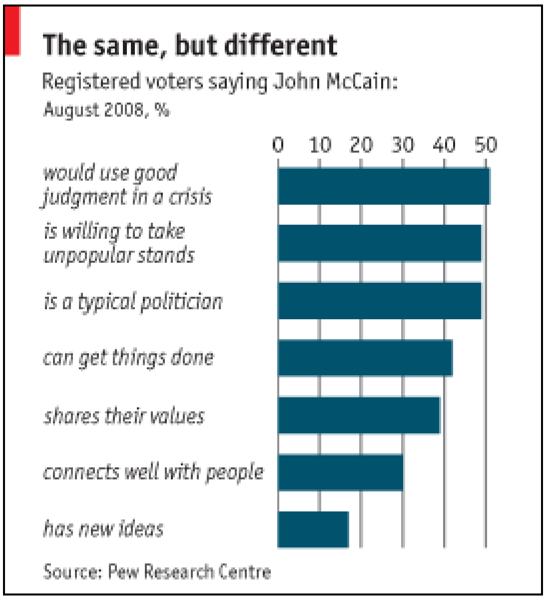
nearly to death. As a prisoner-of-war, he was denied medical treatment until his captors realised he was the son of an admiral. They offered to free him. He refused to go home until the American prisoners captured before him were also freed. That took more than five years, but it was what the navy's honour code required, and Mr McCain did not want the enemy's propagandists to be able to say that, in America, there was one rule for the ruling class and another for the masses.

Voters admire this sort of thing. Mr Obama may write eloquently about the agony of trying to work out how a mixed-race kid fits into America's racial mosaic, but Mr McCain has endured actual physical torture: having his ribs cracked and his teeth knocked out and being stuck in solitary confinement for shouting obscenities at his jailers. None of this necessarily means he would make a good president. But it makes people take him seriously when he says he serves a cause greater than his own self-interest.

Junk food and bad jokes

Mr McCain says he enjoys being the underdog, which is just as well. If this year's presidential election is a dogfight, any Republican candidate starts with his ammunition all but spent and both wings on fire. The economy is in the doldrums. House prices are sliding. Petrol costs two and a half times as much as it did when George Bush came to power. Americans are sick of the war in Iraq, sick of their president and hungry for change. As the nominee of the incumbent party, Mr McCain should have no chance at all.

Yet most polls showed him in a statistical dead-heat with Mr Obama going into their two conventions. That partly reflects voters' reservations about Mr Obama. Some worry about his inexperience or his unsavoury friends. Some are unsure what all that rhetoric about hope and change really means. Some, alas, are unwilling to vote for a black man. But part of the credit for the way Mr McCain outperforms his party must go to Mr McCain himself.



For one thing, the senator from Arizona is a redoubtable campaigner. It is hard to name another politician who is such a mediocre public speaker, and yet so effective. His speechwriter, Mark Salter, prepares him elegant texts that he stumbles through like a man of homely tastes choking on nouvelle cuisine. His voice has no range; he stresses the wrong words. Yet people listen, because they think he means what he says.

He projects the blokeish persona of a man who used to drink too much, crash planes and chase women. On the campaign trail, he wolfs culturally significant junk food—"Pronto Pup" deep-fried hot dogs in Grand Haven, Michigan, or "concrete" frozen custard in St Louis, Missouri—with apparent relish. He has a stock of awful jokes, which he repeats so often that his staff have the punchlines printed on T-shirts. Unlike his more nuanced opponent, he couches straightforward convictions in simple terms. And he salts his message with earthy anecdotes and self-deprecating asides.

Mr McCain is at his best taking questions from unscreened voters, something most politicians seldom dare to do. He seems empathetic, albeit in a gruff, grandfatherly way; and crucially, unlike most politicians, he lets dissatisfied questioners ask follow-up questions until they run out of puff.

Mr McCain's unusual openness helps to explain why journalists, even ones who don't warm to Republicans, often make an exception for him. Whereas Mr Obama tosses only sporadic crumbs to the hordes of scribblers who follow him, Mr McCain spends hours at the back of the bus blabbing with them. Other politicians seek to minimise gaffes by never voluntarily saying an unscripted word. Mr McCain takes the opposite approach. By opening up, he lets reporters see how he thinks and what he knows. As a result, hacks tend to cut him some slack, for example when he confused Sunni terrorists with Shia ones. Any journalist who has spent time with him knows he knows the difference.

The downside of Mr McCain's openness, of course, is that it exposes his weaknesses as well as his strengths. He knows a lot about geopolitics, but embarrassingly little about economics. He is intelligent, but not as intelligent as his opponent. He is a man of principle, but his principles are neither unwavering nor always coherent. And he has a short temper.

Mr McCain's credibility on issues of national security has played a huge role in his success. His father and grandfather were admirals. He has sat on the Senate Armed Services Committee for two decades. When he talks about military affairs, voters know he is not just regurgitating briefing notes. He insisted that Mr Bush had not sent enough troops to pacify Iraq long before the success of the "surge" proved that he was right.

When anything happens to remind Americans that the world is a dangerous place, Mr McCain's stock rises. The murder of Benazir Bhutto in December probably helped him win the New Hampshire primary less than two weeks later. Russia's recent invasion of Georgia made him look prescient. (Mr Bush once gushed that he looked into Vladimir Putin's eyes and saw his soul; Mr McCain quipped that he looked into his eyes and saw "a 'K', a 'G' and a 'B'.")

But will foreign policy always be a strength? Deliberately misconstruing a McCain comment, Democrats have suggested that he wants to occupy Iraq for 100 years. In fact, the gulf between the two candidates on Iraq has narrowed since the end of the Democratic primaries. Mr McCain wants to make Iraq stable and then pull out. Mr Obama wants to pull out as soon as possible, provided that Iraq is stable. How far apart these positions really are depends on how differently you think each candidate would react to developments on the ground. Mr Obama would doubtless withdraw more American troops more quickly, but perhaps not much more quickly.

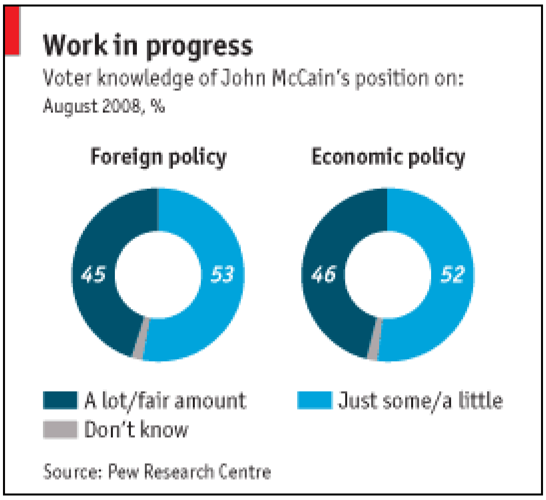
A more fertile area of attack for the Democrats might well be Mr McCain's general bellicosity. Back in 2000, his keenness to stamp American democracy on the world made him the neoconservative pick ahead of the milder Mr Bush. Mr McCain, whose political hero is the warlike Teddy Roosevelt, would certainly be readier to bomb Iran than Mr Obama would. And although he has a much better record of getting on with allies than Mr Bush, his scheme for a League of Democracies has plenty of pitfalls.

Economic wobbling

On economics, Mr McCain's record has been pretty sensible. He has favoured free trade, low taxes, light regulation and fiscal responsibility. He has consistently opposed wasteful pork-barrel spending while Mr Obama has indulged in it. Two problems, however, have emerged on the campaign trail.

First, he has lost some of his reputation for fiscal straight-talking. The man who condemned Mr Bush's tax cuts as irresponsible now proposes irresponsibly to expand them. On the stump, he sometimes spouts populist piffle, suggesting for example that oil prices might be reduced by cracking down on speculators. (Mr Obama is guilty of this, too.) And sometimes he says things that make no sense at all, such as when he maintains that a cap-and-trade system for curbing carbon emissions would impose no costs on the American economy.

Second, when it comes to the details of economic policy, Mr McCain often seems out of his depth in ankle-deep water. Asked in July if he supported treasury secretary Hank Paulson's plan to offer a line of credit to shore up Fannie Mae and Freddie Mac, the ailing government-backed mortgage giants, he said: "I do." Asked to flesh out his answer, he said: "I support it."



Given Mr McCain's weakness in this area, his choice of economic advisers matters a lot. His chief economics guru, Doug Holtz-Eakin, a former head of the Congressional Budget Office, is widely respected. But two other advisers, Carly Fiorina and Meg Whitman, are businesspeople rather than economists. (Ms Fiorina was the boss of Hewlett-Packard, a computer firm. Ms Whitman used to run eBay, an online auctioneer.) Both are able in their field, but neither would give a McCain administration the necessary credibility on Wall Street.

Another part of Mr McCain's appeal is his record as a maverick. His opponent has never bucked his own party's orthodoxy on anything important. Mr McCain often has. He pressed for action against global warming when many of his Republican colleagues were still dismissing it as a hoax. He joined hands with a Democrat to enact a campaign-finance reform many conservatives reviled. With Ted Kennedy, he sponsored a bill that would have granted illegal immigrants a path to citizenship, had congressional Republicans not howled it down.

His motives are sometimes mixed. His zeal to curb the influence of money in politics stemmed in part from his shame at having accepted campaign cash and trips on a private jet from a dodgy financier during the savings-and-loan scandal of the 1980s. And, as with his opposition to the Bush tax cuts, he is not always consistent. But even his opponents admit that he is not a typical Republican. “He’s not my candidate,” says Maxine Jones, a black Democrat in Ohio. “[But] I respect him.”

On social issues Mr McCain takes conservative positions, but without obvious gusto. He opposes gay marriage, but half-heartedly. He says he wants to ban abortion, but once let slip that, if his daughter wanted one, he would leave the choice to her. Such moderation, though appealing to swing voters, is anathema to those who equate abortion with murder. But social conservatives have nowhere else to turn. They might stay at home on polling day, but they are unlikely to vote for Mr Obama, who has a 100% rating from NARAL Pro-Choice America, an abortion-rights group.

Talking tough

Mr McCain’s campaign, which nearly fell apart last summer, is running more smoothly now. It lacks the buzz of Mr Obama’s, who has rock stars at his rallies and one of the founders of Facebook organising his online networking. Mr McCain employs a less fizzy mixture of old loyalists and newly hired heavies from Republican central casting. His staff know they are up against a media darling with legions of passionate followers and tons of cash, but they put a brave face on it. The atmosphere on the campaign plane is jovial. Staffers hand out stickers that say: “Tough? You want tough? I travel with John McCain.”

Both candidates started out by promising to conduct respectful campaigns, but that was always a forlorn hope. The race is close, the stakes are high and many voters remain undecided. Neither Mr McCain nor Mr Obama has much executive experience, so voters have no clue whether either could run the federal government. They have little to go on besides the two men’s characters and life histories, which means that each side has every incentive to draw horns on the other guy’s portrait.

Under Steve Schmidt, Mr McCain’s chief strategist since July, the message has grown punchier and more negative. In the tradition of Karl Rove (Mr Bush’s campaign guru), Mr Schmidt seeks to frame Mr Obama’s virtues as vices: to portray his thoughtfulness as waffling and his ability to fire up a crowd as vacuous Hollywood razzle-dazzle. Mr McCain’s TV spots accuse Mr Obama of thinking he is the Messiah but really resembling Paris Hilton. “Celebrities like to spend their millions. Barack Obama is no different. Only it’s your money he wants to spend,” says one.

Such jabs do not go unanswered, of course, and Mr McCain has plenty of soft spots for his opponent to punch. Asked to define “rich”, he unwisely suggested a figure of $5m a year, allowing Mr Obama to joke that he probably thinks people who earn only $3m a year are middle-class. Asked how many houses he and his wife own, Mr McCain could not remember. The Obama campaign pounced, portraying Mr McCain not only as out of touch but also, ahem, forgetful. The McCain campaign shot back with an ad reminding viewers that Mr Obama bought his own million-dollar mansion with the help of Tony Rezko, a convicted felon, ending: “Now, that’s a housing problem.”

The footwork is swift, but some charges are still hard to parry. Mr McCain is rich because he ditched his first wife for an heiress, which somewhat undermines his Joe Sixpack image. And his age (72 on August 29th) is an issue. Mr Obama’s ads accuse him of the “same old politics”, with the emphasis on “old”. Someone has written a book called “72 things younger than John McCain”: they include duct tape, Alaska, chocolate-chip cookies and Dick Cheney. Though Mr McCain seems hale and energetic, plenty of voters worry that his best years may be behind him.

The safer choice?

Come November, the Democrats will almost certainly increase their majorities in the House of Representatives and the Senate. Ironically, the surging Democratic tide gives tactical voters a reason to back Mr McCain. When one party controls both Congress and the White House, its more extreme elements can flex their muscles without hindrance. Historically, presidents have been slow to veto their own party’s bad laws and wasteful spending plans. United government typically leads to fiscal incontinence, as happened in Mr Bush’s early years. Voters may decide that a Democratic Congress needs a grumpy Republican watchman.

But more probably the election will hinge on how swing voters perceive the candidates' characters. This is Mr McCain's greatest advantage. Mr Obama's background as a community organiser and law professor appeals mostly to groups who tend to vote Democratic no matter what—African-Americans, highly educated professionals, people who live in Massachusetts, and so on.

Mr McCain's curriculum vitae, by contrast, strikes a chord with floating voters, such as white working-class men. Only 12% of voters say they trust Congress "quite a lot" or "a great deal" ("paid staffers and blood relatives," quips Mr McCain), whereas a whopping 71% feel that way about the armed forces. Most Americans have only the haziest idea what a community organiser does, but everyone knows that a warrior fights wars. Pro-Obama bloggers insinuate that Mr McCain has embellished his war record, but this smacks of desperation. "Character is important. John McCain has it," says Sallie Smith, a librarian in Missouri. "The rest of the world takes John McCain more seriously because he is more serious," says a fan in New Mexico.

Illustration by Matt Herring

Mr McCain's supporters do not think he will magically end partisan differences or usher in a new age of global harmony. But they think he is the safer choice. This may or may not be true—doubters point to Mr McCain's sizzling temper, that bellicosity and the fact that a man of 72 cannot be utterly sure he will be sprightly and alert in four years' time. But one thing is certain. In a year when Republicans are about as popular as a scorpion in a tub of popcorn, the senator from Arizona gives his party a real chance of beating the odds.

The Democratic convention

Flags, cheers, discipline and doubt

Aug 28th 2008 | DENVER
From The Economist print edition

Barack Obama struggled this week to unite his party

Reuters

THERE were two conventions in Denver this week. One was a joyful event. Cheered on by throngs of jubilant activists, the Democratic Party's brightest and most boisterous speakers praised Barack Obama extravagantly and rejoiced that in a mere four months the Bush-Cheney tyranny will be over.

The other convention, which took place mostly behind the scenes, was more bitter. Some of Hillary Clinton's supporters still cannot believe that Democratic primary voters spurned their brilliant and battle-tested candidate for a smooth-talking novice. And despite the party's heroic efforts to present a united face to the cameras, the cracks kept showing.

Some of the big shots who backed Mrs Clinton are livid that they will not have grand jobs in her administration. Mr Obama, who named Senator Joe Biden as his running-mate last week, appears not to have considered Mrs Clinton. Some Clintonites manage to hide their disappointment, but not all.

Bill Clinton is the most conspicuous sulk. He feels that the Obama campaign "systematically dismissed his administration's accomplishments. And he feels like he was painted as a racist during the primary process," writes Howard Wolfson, Mrs Clinton's former communications director, on the *New Republic* website. Mr Clinton is also said to be upset that Mr Obama seldom asks his advice.

And the former president, who spent the primary season arguing that Mr Obama was not up to the job, cannot seem to stop. Addressing foreign dignitaries on August 26th, he spoke of a hypothetical candidate who "agrees with you on everything, but you don't think that person can deliver on anything." He quickly added that "this has nothing to do with what's going on now." Perish the thought.

If the only malcontents were Mrs Clinton's inner circle, Mr Obama could safely ignore them. But in some polls, barely half of those who voted for Mrs Clinton in the primaries say they will vote for Mr Obama in the general election. Many are unsure, and perhaps a quarter say they will vote for John McCain (a tendency which the McCain campaign gleefully exploited in its ads during the convention). Such polls are hard to interpret. Come November, many Hillaryites will doubtless have got over their rage. But if they do not, Mr Obama is in trouble.

Since the policy differences between Mrs Clinton and Mr Obama are slight, the Clintonites who care most

about policy are typically content to switch their allegiance. Greg Rodriguez, for example, a gay stay-at-home dad from California, says he could not vote Republican because "anyone who says I shouldn't be allowed to adopt children is anti-gay." He has brought up two children with disabilities, having "rescued them from the foster system [when] good white straight parents didn't want [them]." So he says he will back Mr Obama "all the way".

But not all voters focus on policy. Simone Dubois says she saw votes being stolen by Mr Obama's supporters at a caucus in Texas, where she volunteered for Mrs Clinton. She fumes that the Democratic Party ignored her complaints. She says Mr Obama is an opportunist who "can give a good speech with a teleprompter, but that's about it." She says she will probably vote for Mr McCain. In cyberspace, a group called PUMA (Party Unity My Ass) says things about Mr Obama that would make most Republicans blush.

The Obama campaign spent much of the week struggling to stroke the Clintons. On Monday, Michelle Obama praised Mrs Clinton for putting "those 18m cracks in the glass ceiling". On Tuesday, Mrs Clinton was given the prime speaking slot. On Wednesday, it was Mr Clinton's turn.

Mrs Clinton gave one of her better speeches. "Were you in this campaign just for me?" she asked her supporters. Or "Were you in it for all the people in this country who feel invisible?" Barack Obama was her candidate, she cried, "and he must be our president." The next day, she ostentatiously cut short the formal vote so that Mr Obama could be nominated by raucous acclamation from the floor. The general opinion of the punditocracy was that she had done as much as she could to unite the party and bring her followers round. But several of those, interviewed afterwards, felt that while Hillary might have won their support for Mr Obama, he had not won it himself. And cynics noted a lack of warmth or specifics in her praise of her young rival.

After the roll call, Mr Clinton added specifics. Mr Obama, he said, "has a remarkable ability to inspire people", not to mention "the intelligence and curiosity every successful president needs". He has "a clear grasp" of foreign policy. "His family heritage and life experiences have given him a unique capacity to lead our increasingly diverse nation in an ever more interdependent world." In 1992, recalled Mr Clinton, "the Republicans said I was too young and too inexperienced to be commander-in-chief. Sound familiar?" He could not resist saying that his wife was his "preferred candidate". But Mr Obama was now "the man for this job".

Apart from the family feud, the convention was staged with impressive discipline. Speaker after speaker pounded the same message. America needs change. Mr McCain would be more of the same. Hard-working families are hurting. America needs universal health care, alternative energy and to bring the troops home from Iraq with honour. No detail was left to chance. An entrepreneur selling mints in tins with a Democratic donkey logo was barred from the convention because his tins were made in China.

Every speaker who could plausibly do so emphasised his or her humble roots. An exception had to be made for Senator Jay Rockefeller, of course. But other grandees waxed nostalgic about their single mothers or their struggle against adversity. And a succession of ordinary citizens aired their troubles at the podium: a car worker about to lose his job, a flood victim from Iowa, a laid-off textile worker with huge medical bills, and so on. As these non-famous people spoke, the audience chatted loudly among themselves.

After a while, the discipline grew monotonous. Apart from the Clintons', nearly every speech sounded as if it had been written by the same team. Only a few speakers stood out.

Brian Schweitzer, the blue-jeans and bolo-tie-wearing governor of Montana, gave a storming performance, pumping his fists and rousing the crowd to a frenzy of scorn for Big Oil-loving Republicans. "We simply can't drill our way to energy independence, even if you drilled in all of John McCain's backyards, including the ones he can't even remember," he roared.

John Kerry, the Democratic nominee in 2004, bantered about Mr McCain's flip-flops on tax cuts and immigration. Candidate McCain would veto the immigration bill that Senator McCain wrote, he said, somewhat stretching the truth. "Talk about being for it before you're against it," he joked, playing on the line that killed his own presidential campaign.

Dennis Kucinich, a short congressman from Ohio and sometime presidential candidate who claims to have seen a UFO, added a touch of levity by jumping manically up and down at the podium, but Mr Obama's team reportedly censored his punchiest line. According to the *Hill*, a Washington newspaper, he wanted to say of Republicans that "they're asking for another four years—in a just world, they'd get ten

to 20."

Joe Biden waffled. But he managed to sound like a man who knows not only about foreign affairs but also how much it costs to heat a family home in winter. And he promised that under an Obama administration, the eight most dreaded words in English will no longer be "The vice-president's office is on the phone."

The Economist went to press before Mr Obama's stadium speech accepting the nomination on August 28th. Republicans sought to raise expectations impossibly high, by predicting that he would get a 15% post-convention bounce in the polls. That would be extraordinary for a man whose polls have stayed flat all August, and whose nomination of Mr Biden brought him no bounce at all. But this week was his best chance to convince voters eager for change that they can trust him to bring it about.

And the toughest group to reassure may be the white working-class voters who backed Mrs Clinton. "Barack doesn't have a problem with rednecks, but some rednecks have a problem with Barack," says Tony Viessman, a proud owner of "ten to 15" guns, standing outside the convention with a "Rednecks for Obama" sign. The Republicans have fooled them into thinking he will take their guns, he explains, but Mr Obama is smart enough to know that "You can't take their guns away. There'd be a civil war."

The campaign trail

Conventional wisdom

Aug 28th 2008
From The Economist print edition

Illustration by KAL

Gilding the lily

"To give them haircuts and make them all spiffed up for the Democratic National Convention, because they're part of our community as well."

A hair salon in Denver offered free haircuts to homeless people. CBS4Denver.com, August 18th

Who's a pretty boy

"When he had darker hair it was pretty obvious, he had larger plugs. With the lightening of his hair, it looks much, much better now."

A hair-transplant expert comments on Senator Joe Biden's rumoured hair plugs. Politico.com, August 24th

Spoilsports

"Please monitor yourself, and remember that drinks may go to your head faster than you're used to in New York."

The New York State Democratic Party worries about the drinking habits of its delegates in the mile-high city. New York Post, *August 24th*

Contact high

"I was at the hotel watching people exchange credentials and buttons, and it's like a drug exchange: 'I'll give you two of this for one of that'."

Josh Lucas, an actor, on his political observations. Politico.com, August 25th

Stiff upper lip

"Must be killing him."

Phil Bredesen, Democratic governor of Tennessee, on Bill Clinton's attendance at the convention. Associated Press, August 26th

Christian charity

"I'm praying for unexpected, unanticipated, unforecasted rain that starts two minutes before the speech is set to begin."

Focus on the Family, a Christian group based in Colorado Springs, posted a video on its website asking members to pray for rain during Barack Obama's speech on August 28th. The group later removed the video, claiming it was a joke. Associated Press, August 13th

Love bug

“I guess I’ll go with the McCain cockroach. I think he’s got gentler eyes.”

The New Jersey Pest Management Association organised a cockroach race representing the presidential contest. John McCain’s roach won, but ominously appeared to fall asleep the moment it crossed the finishing line. MyCentralJersey.com, August 21st

After Katrina (1)

Half-empty streets

Aug 28th 2008 | NEW ORLEANS
From The Economist print edition

New Orleans is recovering its energy, but not its people

THREE years since Hurricane Katrina hit New Orleans, the shape of the post-flood city is starting to emerge. Demographers put the city's current population at about 325,000, two-thirds the size that it was before Katrina, and expect no dramatic change for the next few years. The Census Bureau thinks the number is quite a bit lower than that.

The loss of so many residents, possibly permanently, has created a raft of problems for a city that already had plenty. A new study notes that about a third of the 50 districts that flooded have yet to regain 50% of their households. And that sorry statistic begets another. A second recent report has found that New Orleans has the country's highest percentage of vacant residential addresses. Most of those vacant units cannot be lived in.

The recovery has been most sluggish in lower-income areas. The Lower 9th Ward, for instance, has only 11% of its pre-storm population of about 14,000. But some relatively affluent sections have struggled too, such as middle-class Lakeview, where the return rate is slightly less than half.

A certain amount of unfairness is inherent in the patchwork of New Orleans's recovery. The levees that failed were guaranteed by the federal government. Nonetheless, for many homeowners, especially those in poorer parts of town, government grants—based on their home's pre-storm market value—have not been enough to pay for rebuilding.

Cash shortfalls are not the only obstacle to a more robust recovery. The city's economy has always been a smoke-and-mirrors affair, based on tourism. But the federal government, while conceding that its old levees were sub-standard, has not given the kind of "never again" assurances—backed up with real money—that might foster confidence in the region.

Leadership has lagged at local level, too. For the time being, the city's representative in Congress is William Jefferson, who faces trial later this year on 16 bribery-related charges. As for the mayor, Ray Nagin's city hall still bears the marks of what the *New York Times* has called "the classic New Orleans blend of possible corruption and certain mismanagement". One city programme, which funnelled federal money to contractors who were supposed to clean up houses and sometimes didn't, is being investigated by the FBI. Mr Nagin's brother-in-law was among the contractors.

But frustration with the mayor owes more to the perception that there is no firm hand on the tiller. The city's violent-crime epidemic shows no signs of waning, with a murder rate far ahead of its nearest American rival. And meanwhile the mayor's most visible hire after the storm, Ed Blakely, a city planner, has faded into the background. Mr Blakely made a splash at first with a plan to focus investment on 17 "target zones". But it remains unclear how these zones are different from any other area of the city. And Mr Blakely's promises to encourage residents to "cluster" in more viable sections of town have yet to be turned into actual programmes.

All that said, things could be worse in New Orleans. The dreadful public-school system is in the midst of a series of radical experiments. The city is now a living education laboratory, with more charter schools than non-charters. An ambitious rebuilding programme has just been unveiled. Idealistic young people from all over the country, many horrified by the images of the city in the wake of the hurricane, have come to offer help.

Although New Orleans is still a laid-back place that likes a good time, the trauma of the storm and the long slog back to normality seem to have energised it. Residents devour news, and a busy network of bloggers has sprung up. Groups of New Orleanians have organised themselves into volunteer militias tackling everything from home repairs to grass-cutting in the parks. That change of attitude could bode better for the future.

After Katrina (2)

The trailers that smelt bad

Aug 28th 2008 | GULFPORT, MISSISSIPPI
From The Economist print edition

After the storm, the poisoning

WHEN Hurricane Katrina displaced more than 1m people on the Gulf coast, the Federal Emergency Management Agency (FEMA) put in a rush order for 120,000 trailers. They were intended as temporary housing. A year ago, more than 50,000 trailers were still in use in Louisiana and Mississippi; today, about 15,000 remain. As the time passed, complaints emerged. The trailers had a funny smell, and residents were coming down with nosebleeds, asthma and headaches.

Some shrugged this off: any shelter after a storm. But as early as 2006, tests showed that some of the trailers contained dangerously high levels of formaldehyde, a carcinogenic chemical used in building materials. The sweltering summers made it worse. FEMA knew about the problems, but ignored them.

That is becoming harder to do. At a House committee hearing last month, Democrats came down hard on the trailer companies. An executive from Gulf Stream, which had $500m in contracts for 50,000 trailers, had assured FEMA that their tests showed formaldehyde levels below one government standard. He failed to mention any of the less lenient standards. Republicans said that the trailer companies were just doing their job and trying to help.

A class-action lawsuit has been filed against FEMA and the manufacturers. FEMA has asked for immunity. Its lawyers point out that it did not make the troublesome trailers. It only bought them, trusting the manufacturers to provide products that were safe.

A national emergency agency should be better prepared to deal with emergencies. But FEMA does not have a good track record in these matters. Last month it submitted a new plan for disaster housing and recovery. The report was a year overdue and incomplete.

Swing states: Missouri

Show me a showdown

Aug 28th 2008 | JOPLIN AND ST LOUIS
From The Economist print edition

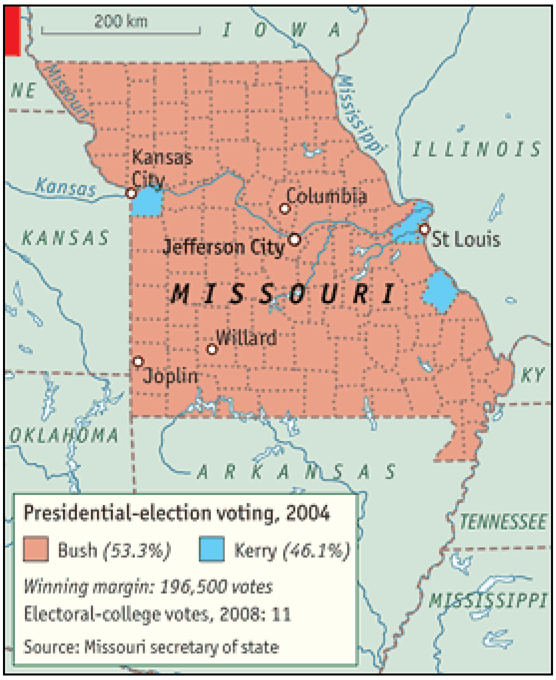
Who can win the state whose capture traditionally leads to the White House?

AT A park in downtown St Louis, three women are drinking Bud Light and watching a demonstration of Scottish tossing-the-caber. It is a peaceful scene at the Festival of Nations, but worries simmer beneath the surface. The women supported Hillary Clinton, and are now undecided. Barack Obama is “a wonderful young man”, but inexperienced in foreign policy. John McCain is “honourable”, but perhaps not up to the task.

These are typical concerns from an average undecided voter in this state. Missouri has 5.8m people and 11 electoral votes. Its moderate size belies its traditional role in presidential elections. There are ways to win the White House without winning Missouri, but few candidates have managed it. The state has voted for the victor in 25 of the last 26 elections. The exception was in 1956, when America went for Dwight Eisenhower, a popular Republican war hero, in a landslide. Missourians gave it to Adlai Stevenson, a cerebral Democrat from neighbouring Illinois.

Why is Missouri such a bellwether? “I guess it’s just the innate good judgment of Missourians or, as you might say, horse sense,” says Nick Myers, a Republican county chair. The mundane explanation is that Missouri is a miniature America. St Louis, on the Mississippi River, is an eastern city. Kansas City, a historic cattle town, looks west. In the south the Ozarks tumble Missouri into Arkansas, and northern Missouri scrapes against the great plains of the Midwest.

The state is also, in some ways, a mirror. It parallels the nation in key categories—about 12% black, 18% mainline Protestant, a bit more than 10% unionised. In rankings of education, income and density, it comes in around the middle.



But one big difference marks out Missouri from the rest of the country. It is just 3% Hispanic; the national number is 15%. The state is becoming older and whiter than America. That trend could affect this election. “Part of Obama’s national appeal is that he represents the new America in terms of the cultural and racial complexity and diversity of the place,” says Wayne Fields, an expert on political rhetoric at Washington University in St Louis. That works better in California than in Missouri, which sees

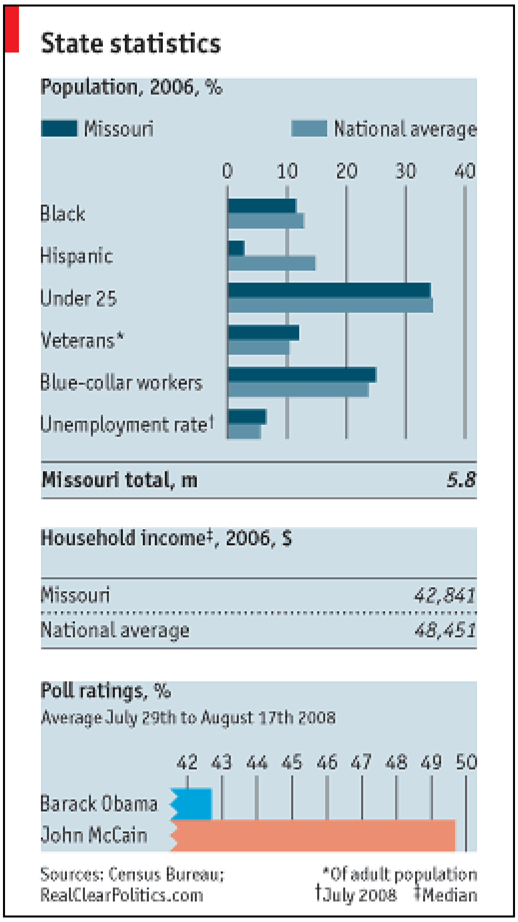
itself “in an earlier place”.

This time, oddsmakers consider Missouri to be leaning Republican. In 2004 George Bush beat John Kerry by seven points there, and the latest Rasmussen poll has Mr McCain up by the same margin. Dave Robertson, a political scientist at the University of Missouri, argues that the 2004 results are a bit misleading; Mr Kerry all but abandoned the state in September. “It’s never a free ride for anybody in this state,” he concludes.

This time, both campaigns are fighting for it. Mr Obama needs to rack up big margins in the urban centres of St Louis and Kansas City, and should carry smaller cities like Columbia and Jefferson City. Mr McCain has to counter that with whopping margins in rural counties. Battle will be joined in the suburbs and the exurbs. The south-western corner of the state may be key. It is Republican territory, but the Democratic senator Claire McCaskill made an impression two years ago when she fought “outstate”. She nibbled away enough of the incumbent Republican’s margins to win a closely contested race.

That made a big impression on Democrats. Last week the Obama campaign was touring rural Missouri in an RV, holding events in small towns like Willard. “Unfortunately, when people watch TV, they see Democrats as Nancy Pelosi,” says Jamie Schoolcraft, the mayor. He has a concealed-weapons permit and his grandfather was a Baptist preacher. People accept that he is a Democrat when he explains his positions to them.

The economy is the key issue for Democrats in Missouri. J.C. Kuessner, a state representative, focuses on home issues at the Willard event: energy prices, country roads, sweetgrass and sorghum incentives, and the farm bill, which Mr McCain opposed. Back on the slightly rickety RV, bound for Joplin, Mr Kuessner says that his constituents “aren’t worried. They are scared.” He adds, incredulously: “People in America being scared?”



The Republicans, he continues, are hopelessly out of touch. The day before, Mr McCain had been unable to say how many houses he owns. Mr Kuessner points at his own brown lace-ups and says that they cost $39 in a sale. He doubts that Mr McCain ever waits for the sales.

For Republicans, the challenge is to shore up Mr McCain’s standing among social conservatives. Later that day, Tom Coburn, a senator from neighbouring Oklahoma, strikes a few defensive notes at a small rally in Joplin. He assures one questioner that Mr McCain has come aboard on immigration. He says that evangelicals should give the candidate the benefit of the doubt: Mr McCain was not brought up to talk about his faith, but it certainly sustained him in Hanoi.

Mr McCain struggled in southern Missouri in the primary, but Republicans there are warming to him. Four years ago, recalls Margaret Thompson, she and her friends would spend more than 40 hours a week volunteering for George Bush. This time she was less enthusiastic—until Mr McCain’s televised appearance at Saddleback church in California. He gave crisp, unequivocal answers about evil (defeat it) and unborn children (give them human rights at the moment of conception). Now, she says, she is convinced of his passion.

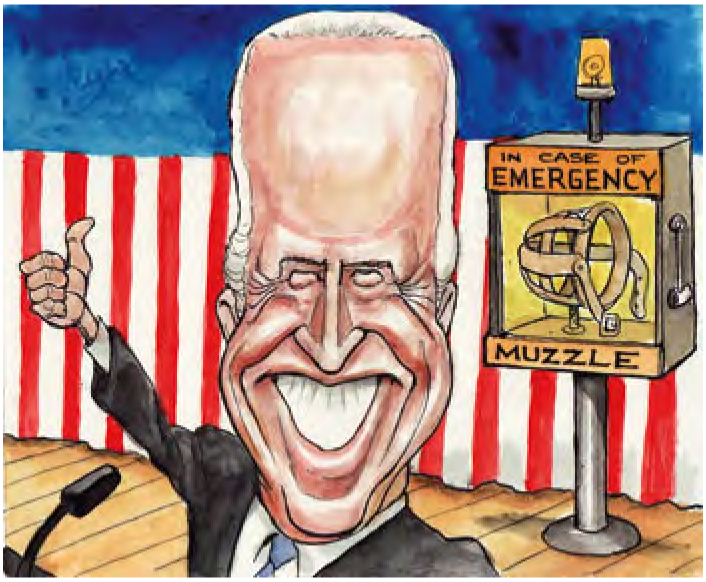
Lexington

Joebama

Aug 28th 2008
From The Economist print edition

Joe Biden brings both strengths and weaknesses to the Democratic ticket

Illustration by KAL



HIS first run for the presidency collapsed, in 1987, after a bizarre act of plagiarism. Bizarre because Joe Biden not only borrowed the words of another politician, Neil Kinnock, the leader of the British Labour Party. That is par for the course in modern politics. He borrowed his life-story, too. He claimed that he was the first Biden to go to university and that his ancestors had worked down a coal mine, both untrue. The only thing he did not claim was to be Welsh.

This was doubly damaging because Mr Biden, like the man whose identity he tried to purloin, is a notorious wind-bag. He loves nothing more than the sound of his own voice. And when he talks the sentences and paragraphs tumble over each other with no obvious end in sight. Members of the audience just have to cross their fingers and hope.

But Barack Obama's choice of Mr Biden as his running mate has nevertheless been greeted with widespread applause—and not just from loyal Democrats. The senior senator for Delaware not only brings white hair to the Democratic ticket. He also brings a (true) personal story that compliments Mr Obama's autobiography. Mr Obama's rally in Springfield, Illinois, on August 23rd, where he introduced his new running mate to the world, was his best performance for some time.

Mr Biden is a perfect example of a lunch-bucket Democrat made good. His father was born polo-playing rich but ended up poor, thanks to a series of bad investments. Young Joe grew up in a solid but struggling working-class family in Scranton, Pennsylvania, before moving to Wilmington, Delaware. He worked his way through college and made it to the Senate by the age of 29.

He remains popular in his native Pennsylvania, one of America's largest swing states. He is a (pro-choice) Roman Catholic who instinctively understands the cultural anxieties that drove his fellow Papists to embrace Ronald Reagan in the 1980s, and continue to make them wary of Mr Obama. He is also one of the poorest members of the Senate, an institution which is threatening to revert to its Gilded Age status as a millionaires' club. He endured an unspeakable personal tragedy, shortly after his first run for the Senate in 1972, when his wife and daughter were killed by a drunk driver. He travels home to his family in Delaware every day on Amtrak, and lives in a surprisingly modest house. All this makes him appealing to Obama-wary working-class voters.

Mr Biden is one of the most experienced foreign-policy hands in Washington. He has been the chairman of the Senate Foreign Relations Committee since the Democratic takeover of Congress in 2007, with a particular interest in eastern Europe, and is on first-name terms with many foreign politicians. A fortnight ago Mikheil Saakashvili, the president of Georgia, invited him to visit his embattled country. He is also “a happy warrior”—a man who relishes the pig-wrestling side of politics, and can deliver a killer punch without seeming malicious.

This is a perfect compliment to Mr Obama’s biggest weaknesses, his wafer-thin résumé on foreign affairs. It will stand him in good stead in the vice-presidential debate, which could prove surprisingly important in a close race. The fact that he is a good friend of John McCain—the two men have served together in the Senate for two decades—could also help the Democrats to wrong-foot their opponent.

Mr Biden’s strengths extend beyond the campaign trail. Dick Cheney is hardly a name to conjure with in Democratic circles. But Mr Biden brings some of the same qualities to the Democratic ticket that Mr Cheney brought to the Republican one in 2000. At 65, he has no choice but to sublimate his personal political ambitions into those of his boss; and, as an old Washington hand, he knows how to get things done. Mr Obama’s supporters seem to believe that all they need to do is huff and puff and the old order in Washington will come tumbling down. Mr Biden understands that, in order to achieve results, you need to know how to manage committees and flatter power-brokers.

Mouth trouble

The Republicans have wasted no time in charging that Mr Biden undercuts his boss’s message of “change”. But this is transparently self-serving. If Mr Obama had picked a less experienced man—Tim Kaine, the governor of Virginia, another swing state, for example—they would be mocking the Democratic ticket as lightweight. Still, the man who tried to borrow Mr Kinnock’s biography has worrying weaknesses.

The most obvious, of course, is his mouth. The Republicans have already produced a video of Mr Biden arguing that Mr Obama is too inexperienced for the top job, and proclaiming that he would “be honoured to run with or against” Mr McCain. Mr Biden once described Mr Obama as “the first mainstream African-American who is articulate and bright and clean and a nice-looking guy”. There will be plenty more where that came from.

A second problem is that his judgment in his major area of expertise, foreign policy, has proved up and down. He argued that Iraq should be partitioned, into Sunni, Shia and Kurdish regions, and stuck to his harebrained scheme long after it had been debunked both by American military commanders and by Iraqi politicians. Like Mr Obama, he bet against the success of the “surge”. All grist to the Republican mill.

Mr Biden’s biggest problem, however, is that he is not Hillary Clinton. Mrs Clinton won 18m votes in the Democratic primary; Mr Biden dropped out after coming fifth in the Iowa caucuses. Mr Obama’s advisers have whispered that the reason Mrs Clinton was not considered for the vice-presidency is that she is a Washington insider who voted in favour of the Iraq war. But Mr Biden is also a Washington insider who voted in favour of the Iraq war. Far from bringing Mrs Clinton’s supporters back into the fold, Mr Biden’s elevation may look like just another snub.

Brazil

A funny kind of reward

Aug 28th 2008 | RIO DE JANEIRO
From The Economist print edition

Petrobas

Just when production from Petrobras's big new oilfields gets going, the government ponders changing the rules on oil exploration

SEEN from the dock at Angra dos Reis, the port south of Rio de Janeiro where it is moored, Petrobras's P-51 oil rig looks like a chemistry set the size of several apartment blocks. Once on board it is easy to get lost among all the tubes at its dark and claustrophobic centre. This being Brazil, however, space has been made for a football pitch. From the top deck the view is vertiginous; in the heat of a Rio winter the indigo water far below is inviting. In a few months this $830m piece of kit, one of the world's mightiest oil rigs, will be towed 175km (110 miles) from shore and anchored to the sea bed, where it will begin sucking up oil and gas—and with it, creating a chunk of Brazil's economic future.

Last November Petrobras, a state-controlled oil giant, announced that it had found between 5 billion and 8 billion barrels of light, sweet crude in a field called Tupi, wedged under a layer of salt deep beneath the floor of the Atlantic Ocean. There is a strong presumption of more oil in other “pre-salt” fields. In April the head of the agency that hands out exploration licences casually mentioned a figure of 33 billion barrels, before sheepishly saying that he had been quoting from a Texan energy magazine. Next month the first barrels of oil will emerge from the new fields.

Exploiting Tupi poses huge technical challenges. The salt has acted as a “perfect seal” to preserve the oil, says Antonio Carlos Pinto, who directs Petrobras's projects in the pre-salt fields. But the oil sits between 5.3 and 7km below sea level, farther from the surface than any of the world's existing fields. The company already extracts oil and gas at a depth of nearly two kilometres and has the technology to go a kilometre deeper. But Tupi is a lot more complex. The oil comes out hot and then cools rapidly as it flows towards the surface, depositing paraffin that clogs up pipes along the way. It emerges under 230 times more pressure than the air in a car tyre. Some of the fields are 300km off the coast, making it difficult to get workers to them by helicopter.

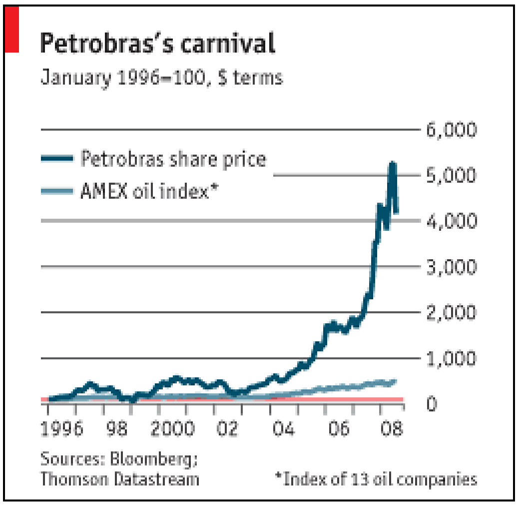
Oilmen reckon that Petrobras has both the technical expertise and the financial muscle to exploit Tupi. It has drilled in deep water since the first steep rise in the oil price in the 1970s. The recent high price has sent the firm farther offshore and deeper under the sea, and set its 1,800-strong research department new tasks. Drilling the first well into the pre-salt took a year and cost $240m. The latest wells take just 60 days, at a cost of $1m a day.

Most of Petrobras's planned investment in exploration and production of $65 billion over the next five years will be spent on the new fields. José Sergio Gabrielli, Petrobras's president, says that the

company's plans for expansion are predicated on oil at $35 a barrel. He also says that the company has the financial strength to raise more debt if necessary.

Yet just as Petrobras has struck a bonanza, Brazil's government is debating whether to create a new, wholly state-owned, oil company to maximise its profit from the new fields. This echoes a campaign in the 1940s that led to the creation of Petrobras in the first place, under the slogan "the oil is ours". But much of Petrobras's new stature and success comes from the decision of a previous government to float 60% of its shares on the stockmarket and to open up the oil industry, allowing foreign firms in as partners and competitors.

Uncertainty has now caused Petrobras's share price to wobble (see chart), taking the rest of the São Paulo stockmarket with it. At the moment, the government takes a royalty of up to 10% of the value of oil and gas. In addition, there is a second tax linked to production. Much of this second levy goes to the states where the oil is—mainly Rio de Janeiro. On top of this, of course, the government reaps dividends from its 40% share in Petrobras, which is the fifth-largest company in the Americas by market capitalisation.



A government committee is looking at how best to increase the state's oil take, and will give some preliminary findings on September 19th. One of two options seems likely. First, as has been suggested by President Luiz Inácio Lula da Silva and by his energy minister, Edison Lobão, the government could create a new company that would partner any firm (including Petrobras) exploring in the pre-salt areas that have yet to be auctioned. Second, taxes on profits could be raised for new concessions. Either change is likely to need ratification by Brazil's Senate.

Officials, including Mr Gabrielli, argue that since drilling in the pre-salt is now almost certain to yield oil, the rewards for investors in new blocks should reflect this lower exploration risk. That is in itself not unreasonable.

But there would be several dangers in completely rewriting the rules. Though Petrobras, subject to market discipline, is relatively lean, any new state company might quickly become puffed up by political appointees. Second, the government might be tempted to revisit existing contracts, which would be bad for confidence and disastrous for Petrobras and its partners (Britain's BG Group has a 25% stake in Tupi and Portugal's Galp Energia 10%). Third, shutting out Petrobras's outside shareholders might scare off foreign investors from Brazil in general. Whether Petrobras will stand up for those shareholders is unclear. The company's board is chaired by Dilma Rousseff, Lula's chief-of-staff and seemingly his candidate for a presidential election in 2010.

The oil find comes in the twilight of Lula's presidency. He seems to see ring-fencing social spending as a way to cement his legacy. He wants much of the oil money to be earmarked for education, which is one area where his officials are conscious of having fallen short. This has its own dangers: public education in Brazil is badly run and needs to be reformed before it is showered with money, or else much will be wasted. Yet before it gets ahead of itself, the government should first make sure that it does not damage the company that located the treasure in the first place.

The Amazon

Tread softly

Aug 28th 2008
From The Economist print edition

Oil and gas extraction does not have to hurt the rainforest, or its people

ON THE face of it, a mostly peaceful protest by several thousand tribespeople in Peru's Amazon jungle this month was a resounding victory for those who shook placards and spears. On August 22nd Peru's Congress repealed two presidential decrees, approved in May and June, that made it easier for companies and individuals to buy land belonging to indigenous peoples by reducing the necessary consent from a two-thirds vote by an entire community to that of half the attendees at a mass meeting. The protesters, who occupied oil installations, claimed that many of them would lose their land unwittingly.

Alan García, Peru's unpopular president, argues that do-gooding NGOs are blocking his country's drive for economic development. The protest, and the repeal of the decrees, was an embarrassing setback for the government. Other decrees regulating oil exploration will now be reviewed by an all-party committee.

The issues raised by the dispute are complex—and they apply across much of the Amazon basin. In Peru, as elsewhere in Latin America, the state owns the subsoil, and any oil, gas or minerals it contains. Since 2005 the proportion of Peru's rainforest earmarked for oil and gas exploration has expanded from 15% to 72%. But Indians have title to much of the land above: 58 of the 64 oil blocks on the map of Peru overlap Indian land, of which 17 overlay existing or proposed reserves for people living in voluntary isolation.

Peru plans to award 22 more oil blocks, many in the jungle, next month. Colombia will soon do the same in its southern jungle. Hugo Chávez, Venezuela's president, has championed an impractical plan to pump his country's natural gas across the Amazon rainforest to Buenos Aires. Venezuela's state oil company is helping a newly revived Bolivian state firm explore rainforest. Ecuador has found oil in the Yasuní national park. The government of Rafael Correa has promised Indian tribes not to exploit this—if rich countries pay it $350m a year over the next decade (half the field's estimated revenue). Germany and Italy expressed interest, but the latter seems to have been put off by the deal's fuzziness.

In the past oil companies often adopted a nonchalant approach to the environment. They informed local people before drilling and pumping on their land, rather than gaining their prior consent. A more careful approach is needed to reconcile national interests with those of the inhabitants of the rainforest.

Such a reconciliation is not impossible. Oil and gas extraction has the potential, at least, to bring wealth with less impact on the rainforest and its natives than cattle ranching, soya farming or most forms of

logging. Some NGOs are encouraging oilmen to look at the jungle as they would the ocean, sending workers and kit by helicopter—not newly carved road—and sucking out oil and gas from fewer rigs. This is possible, thanks to a technique known as extended-reach drilling. This involves drilling a well down and then horizontally underground for up to 12km. New rigs planted in untouched forest can be 20km apart, says Bill Powers, an engineer and consultant for green groups.

Some oil companies are sceptical. In a 2005 report, Pluspetrol, an Argentine firm, concluded that extended-reach drilling could not work at its Camisea gasfield in southern Peru without causing underground rock to crack and without installing stronger pumps. Steve Suellentrop, the boss in Peru of Hunt Oil, a Texan firm working with Pluspetrol, says that it is operating "at the physical limits of what can be done technologically". It employs "directional drilling" over shorter distances.

Mr Powers, for one, thinks more could be done to reduce environmental impact. Shell, which discovered the Camisea field in the 1980s, once moved a rig, pumps and workers' camp behind a hill at the request of an Indian village, says Murray Jones, who worked there for Shell when the rig was moved. Shell's workers then drilled back to their original starting point, 1.5km away. Mr Jones, who is now a consultant, thinks that this sort of arm's-reach extraction may be cheaper than planting more metallic towers among the trees.

Exploratory work can be done better, too. Instead of bulldozers, many companies nowadays employ machete-wielding labourers to hand-cut pathways for seismic surveys. More use of aerial imaging can reduce the dynamited area. Oil companies are more likely to inject waste water and toxic residues back into the ground than let them spill into jungle rivers, after two lawsuits, one against Texaco (now part of Chevron) for its operations in Ecuador in the 1980s and another against Occidental Petroleum.

Campaigners are strangely reluctant to target state-owned oil firms. That is odd since their environmental record is often worse than that of private companies. But not always: greens praise the Urucu gas project in the Brazilian Amazon run by Petrobras, Brazil's partly state-owned oil company (see article). Petrobras is building a pipeline that will eventually reach Manaus. The parts come by chopper or river and the builders, two-thirds of whom are locals, sleep on boats. There are almost no roads, which averts much of the illegal logging, disease and destitution that often follows forest development. Similar standards would surely make Peru's indigenous peoples more content.

Colombia

Your tape or mine?

Aug 28th 2008 | BOGOTÁ
From The Economist print edition

The president and the courts

FOR months President Álvaro Uribe's government has been seeking a consensus on proposals to reform Colombia's judiciary and its political system. Yet when the interior minister, Fabio Valencia Cossio, delivered the reform bills to Congress this week, he unceremoniously dumped them, without the customary speech. That was because of a new bout of squabbling between Mr Uribe, the opposition and the judges that has overshadowed the bills.

At issue is "parapolitics": links between politicians and right-wing paramilitary groups, many involved in the drug trade, which fought left-wing guerrillas by imposing a reign of terror on parts of Colombia, and whose leaders were persuaded to demobilise by Mr Uribe. The Supreme Court has remanded 29 current or former lawmakers, and is investigating a further 39, over paramilitary ties, proven or alleged. Most are supporters of Mr Uribe.

The president claims the courts are pursuing a political vendetta. In some cases, that may be so. Mario Uribe, a former senator and the president's cousin, was freed from four months in prison on August 20th after a prosecutor found there was insufficient evidence to hold him. Another former congressman was freed after 15 months in jail after a judge ruled that he was intimidated into signing an alliance with the paramilitaries.

But the judges accuse the government of a similar vendetta. This week, *Semana*, a newsweekly, revealed that aides of Mr Uribe met the emissaries of Diego Murillo, a paramilitary warlord, who offered them a video in which a man they falsely claimed was from the court offered Mr Murillo bribes to testify against politicians. The Supreme Court's president claimed this was a "conspiracy" against the court; Mr Uribe said the government had to hear Mr Murillo's people "because there is trafficking in witnesses" in parapolitics cases. To make matters worse for the government, another tape has surfaced which appears to link the interior minister's brother, a provincial prosecutor, with a drug trafficker. (The brother denies the claim.)

All agree that Colombia's democratic institutions need reform. One bill would punish parties whose lawmakers are found guilty of "parapolitics". The other would remove responsibility for prosecuting lawmakers from the Supreme Court, vesting it in the attorney-general. Some Colombians think the bills would increase the credibility of their democratic institutions. Others note that the president has a hand in choosing the attorney-general, and fear a backward step. But since the opposition, some of whose votes are needed for the bills' passage, promptly said it would refuse to debate them, their approval looks far from assured.

The Caribbean and the Olympics

Champs and chumps

Aug 28th 2008
From The Economist print edition

Why Jamaica outpointed Cuba

Illustration by Claudio Munoz

AN E-MAIL circulating in Jamaica states that international sporting authorities have banned cassava on the grounds that it is a performance-enhancing substance. This was a wry comment on the remarkable success of an island of only 2.7m people at the Beijing Olympic games. Jamaica won 11 medals, of which six were gold. In doing so, it knocked its bigger neighbour, Cuba, from its perch as the Caribbean's sporting power. The Cubans returned home with just two golds, their worst showing since 1968.

What explains this reversal of fortune? In large part, who got to compete. All of Jamaica's medals came on the track. The Champs, as Jamaica's high-school athletics championship is called, is the country's top sporting event, televised nationally and held in a big stadium. This may explain why Usain Bolt, the world's fastest man, was not coaxed into throwing his energy into basketball, cricket or football (though he has the physique to excel at the first two). More than genetics, it is this national specialisation which has allowed Jamaica to emerge as a track power.

Cuba spreads its talent more widely. Its Communist rulers have set great store by Olympic success as a symbol of political superiority. But it is boxing at which Cubans have long excelled. Whereas boxers elsewhere turn professional as they get older and better, Cuba's state-sponsored "amateur" fighters remain eligible for the Olympics. When offered $1m to fight by Don King, an American boxing promoter, several Cuban champions are said to have replied that they would rather fight for 10m Cuban people.

In Beijing, Cuba's boxers still managed eight medals (a third of the country's respectable total haul of 24). But there were no golds. That may be because three of the five gold medallists in Cuba's 2004 Olympic team have since defected; a fourth languishes in Havana, disgraced for trying to do the same. Because of official fears of more defections, the boxing team did not travel to the 2007 world championships, held in Chicago.

There is, however, another theory. According to Fidel Castro, who wrote an editorial on the subject this week, Cuban boxers were robbed by malicious referees. A Cuban Taekwondo fighter, Angel Matos, was banned for life, along with his trainer, when he delivered a vicious kick to the head of the referee who had just disqualified him for taking too long to get medical attention. Mr Castro declared himself in "total solidarity" with Mr Matos and his coach. So it's official: Jamaica has eclipsed its island neighbour because of an imperialist plot.

Malaysia

Sodomy and the backlash

Aug 28th 2008 | KUALA LUMPUR
From The Economist print edition

A sweeping by-election victory takes Anwar Ibrahim, the opposition leader, a step closer to power. The government seems blind to the danger signals

AP

Get article background

AFTER an ugly, mudslinging campaign, a by-election on August 26th in the northern constituency of Permatang Pauh may have changed Malaysia's political landscape permanently. The stakes were high. The main opposition leader, Anwar Ibrahim, bidding to return to parliament, had to win convincingly to keep up the momentum of his drive to unseat the United Malays National Organisation (UMNO) and its allies, which have ruled since independence from Britain in 1957. The government, which lost its two-thirds majority (needed to change the constitution) in a general election in March, wanted at least to deny Mr Anwar a big majority. But he won by almost 16,000 votes, 2,000 more than in March, when his wife (with Mr Anwar above) defended the seat.

So Mr Anwar's second shot at power remains on track. Ten years ago he was deputy prime minister and UMNO's heir-apparent. But he was brought down by trumped-up charges of "sodomy", a crime in Malaysia, after falling out with the then leader, Mahathir Mohamad. Mr Anwar was jailed for this and a further charge of corruption, then freed in 2004 after Dr Mahathir had handed the reins of power to the current prime minister, Abdullah Badawi. Mr Anwar has since built an unlikely opposition alliance. His own, multiracial People's Justice Party (PKR) has teamed up with both the Islamic Party (PAS), which appeals to Malaysia's Muslim, ethnic-Malay majority, and the firmly secular Democratic Action Party (DAP), whose main base is the ethnic-Chinese minority.

In June, soon after a ban on Mr Anwar's holding political office expired, a young male aide made familiar-sounding accusations of sodomy, for which Mr Anwar will, again, go on trial soon. The government insists this is no put-up job, though to its embarrassment it soon emerged that the accuser had met Mr Badawi's deputy, Najib Razak, and other government officials. In the by-election campaign, the government side constantly played video clips of Mr Anwar's accuser swearing on the Koran that his allegations were true. In turn, the opposition reminded voters of the gruesome murder of a Mongolian woman, over which one of Mr Najib's advisers and two police bodyguards are on trial.

Little of the mud slung in Mr Anwar's direction seemed to stick. According to a poll by Merdeka Centre, an opinion-research outfit, the weekend before the by-election, 59% of voters in Permatang Pauh thought the sodomy allegation politically motivated, and only 11% deemed it the main issue in the election, compared with 32% who thought the economy was. Mr Anwar promises to abolish the policy of giving Malays preference for state jobs and contracts, arguing that it has mainly benefited the well-connected

few. Ethnic Malays, by voting for Mr Anwar in large numbers, seem to have rejected the government's charge that he is a traitor to his race.

Zaid Ibrahim, a lawyer whom Mr Badawi recently brought into his cabinet to lead the reform of a corrupt judiciary, says the lesson from the by-election is that voters are tired of personal attacks, and of the "overkill" tactics the government turns on its opponents. It should, says Mr Zaid, start showing the opposition some respect and engage it in a policy debate.

Other ministers, however, are much more relaxed about the by-election defeat. Shabery Cheek, the information minister, argues that the governing coalition has recovered from similar setbacks before. Furthermore, he says, Mr Anwar was campaigning in his home constituency, in a seat he used to occupy before his 1998 troubles, so his comfortable win was not that significant. Syed Hamid Albar, the home minister, notes that voters still gave the UMNO-led coalition a majority in the general election: this shows, he argues, that they still want the government in power, even if they also want to give the opposition a stronger voice.

For Bridget Welsh, an American academic who studies Malaysia, this laid-back view suggests that much of the government is "in denial" about the message the voters are sending. Hitherto, says Ms Welsh, Malaysians have been rather risk-averse. But ministers may be underestimating the effect that access to uncensored news, via the internet, is having in changing people's views. To relieve the pressure for his resignation over the March election upset, Mr Badawi has promised to hand over to Mr Najib in 2010. Ms Welsh notes that since Mr Najib is popular within UMNO, but is seen outside it as a hardliner, his rise may not solve the party's problem with voters.

Mr Anwar claims he is close to prising enough parliamentarians from the government benches to give him a parliamentary majority—he even boasts of taking power by September 16th, Malaysia Day. But this will be a tall order. His alliance has 82 seats in the 222-seat lower house. He would need comfortably more than the minimum of 30 floor-crossers to form a stable government—and in practice most would need to be Malays, ie, from UMNO rather than its non-Malay coalition partners. Most potential defectors will be loth to jump ship unless they feel sure the government is about to collapse.

Mr Anwar says it is not that important if he does not get enough defections by September 16th. He argues that the "climate of change" among the public, especially the Malays, means that the momentum behind him is now unstoppable. However, Tricia Yeoh, of the Centre for Public Policy Studies, a think-tank, says that to maintain it, the opposition leader must urgently press on with forming a credible shadow cabinet, to show that his disparate alliance has the "seriousness and capability" to take on the job of government.

What if UMNO does fall, either through defections in the short term or by losing the next election, and Malaysia gets its first alternation of power? Many institutions of state—especially the police, courts and civil service—are deeply politicised. But Ong Kian Ming, a political scientist, reckons that most would fall in line if the opposition takes power, as long as Mr Anwar avoids provoking them needlessly. Most big Malaysian businesses, despite their cosiness with the current government, would also prefer an Anwar government to a prolonged period of political instability. In the meantime the government looks likely to do everything it can to retain power. Except, it still seems, the one thing that might work: showing some tangible progress on the reforms Mr Badawi keeps promising but never provides.

Myanmar

Suu Kyi skips a meeting

Aug 28th 2008
From The Economist print edition

Get article background

Reuters

The ruling junta denied suggestions from supporters of Aung San Suu Kyi, the detained opposition leader, that she may have started a hunger strike in protest at its refusal to discuss democratic reform. But bags of food delivered to her house have not been picked up, and her colleagues have expressed concern for her health. Ibrahim Gambari, a United Nations envoy, left Myanmar after a six-day visit in which neither Miss Suu Kyi nor Than Shwe, the junta's leader, would see him. Miss Suu Kyi's supporters accuse Mr Gambari of appeasing the regime, by discussing its plans for an election in 2010 under a constitution the opposition rejects. Miss Suu Kyi has met Mr Gambari on earlier visits. The photograph of an encounter last year suggests she did not find the experience fruitful.

Economist.com WORLD ASIA

Thailand

No compromise

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From The Economist print edition

A three-year political conflict grinds on, as protesters besiege the government

WHEN Thailand's deposed prime minister, Thaksin Shinawatra, fled to Britain on August 11th with his wife Potjaman, to escape corruption cases against them, some Thais hoped this would lower the temperature of the country's three-year-old political conflict. But the anti-Thaksin People's Alliance for Democracy (PAD) insisted it would not stop protesting until it forced the resignation of the pro-Thaksin government of Samak Sundaravej, a prime minister who is a self-proclaimed "proxy" for Mr Thaksin. On August 26th tens of thousands of PAD supporters stormed government buildings and a state television station in Bangkok.

The next day, with thousands of protesters still camped out in the government compound, the courts issued arrest warrants for the group's leaders on charges including treason and illegal assembly. Riot police surrounded the compound, and appeared poised to move the estimated 14,000 demonstrators by force. Yet, as has happened in the past, Mr Samak soon changed his tune, saying he would not use violence and that the protesters could stay as long as they wanted. Even so, what happens next is hard to predict. The PAD has repeatedly made extravagant claims about being on the brink of bringing down the government, and of being ready to fight for its cause, only for its protests to fizzle out. If the police do use force to remove the protesters, there is a danger of bloodshed.

Indeed, the PAD's intention may be to provoke the army into staging another coup, like the one in 2006 that removed Mr Thaksin. That is certainly Mr Samak's analysis. The army chief, General Anupong Paochinda, insisted that his troops would leave the handling of the protests to the police. But in the past the army has been intolerant of public disorder; it believes it has a duty to intervene when things get out of hand. Two years ago, General Anupong's predecessor, Sonthi Boonyaratglin, kept repeating that there would be no coup right up until the evening he put tanks on the streets to remove Mr Thaksin.

Mr Thaksin's Thai Rak Thai party was disbanded by the courts after the coup but regrouped under the banner of the People's Power Party (PPP). In December last year, after 15 months of inept military government, the PPP won more seats than any other party in a general election, since when it has governed in coalition. Rural Thais expressed their appreciation to Mr Thaksin's party for being the first in Thai history to promise—and deliver—policies that met their needs, such as cheap health care and credit. This inclined them to overlook the strong whiff of corruption around the Thaksin government and its abuses of power, most notably a 2003 "war on drugs" in which the police were suspected of thousands of extra-judicial killings.

Mr Samak is determined to stay in office. He has sought to build bridges with the army and the royalist Bangkok establishment, which opposed Mr Thaksin. The PAD dresses its supporters in yellow, a colour associated with King Bhumibol, and claims to be saving Thailand and its monarchy from the Thaksinites' supposed republicanism. Some of its supporters are genuine liberals, angry at the Thaksin government's abuses and at the signs that Mr Samak and his cabinet are turning out to be little better. But its leaders are deeply reactionary: the "new politics" they preach is in fact a return to old, pre-democracy politics with a mostly unelected parliament and powers for the army to intervene when it feels like it.

This and the PAD's reckless tactics have lost it much of the support it once had among the Bangkok elite (many of whom also supported the 2006 coup, and later regretted it). So a point may soon be reached at which the police and government can safely move against its leaders. This would still risk violence. But so would letting the conflict rumble on.

The Beijing Olympics

Our revels now are ended

Aug 28th 2008 | BEIJING
From The Economist print edition

A substantial pageant, but its fading leaves not a wrack behind

IT ALL went much as China's leaders had hoped. The ceremonies were spectacular, the stadiums as good as any in the world and China won far more gold medals than any other country. The world's most important politicians showed up and no one, bar a handful of vexatious foreigners, staged protests. But after spending tens of billions of dollars and huge political energy, China's leaders might be wondering whether it was all worth it.

The occasional glimpses on national television of their wooden expressions as they watched the closing spectacular of the Olympic games on August 24th revealed little of what they felt. This was a show they had helped to choreograph, sometimes in minute detail. But they have suppressed almost all public discussion about the choices they made and the expense involved.

Officially the games cost $2.2 billion, compared with an original estimate of $1.6 billion. Beijing also spent $40 billion on preparing its infrastructure and cleaning up the environment. But China's secretive budgeting system makes it impossible to verify these figures. Chinese officials say the infrastructure had to be built anyway and that spending was in line with that of previous host cities. But the impression given was of little expense spared.

Vice-President Xi Jinping, at least, has reason to celebrate. The games were his first big political test since he emerged as China's leader-in-waiting after a Communist Party congress in October last year. Mr Xi took charge of preparations for the games, a move apparently aimed at demonstrating the importance the party attached to them (officially a lower-ranking Politburo member, Beijing's party chief, Liu Qi, remained the top organiser). Organisationally the games went well.

Less clear is whether the games will pay the kind of political dividends that China had hoped for domestically and abroad. The gold-medal haul (51 compared with America's 36 and 23 for Russia) will boost national pride. But many complain about the impact that stringent security precautions and tightened visa restrictions for foreigners have had on business. Security has been particularly intense in Tibet and neighbouring Xinjiang. This may well worsen grievances among their inhabitants and strengthen pro-independence sentiment in both regions.

For all the good cheer generated by the gold medals, the party is clearly nervous of the slightest challenge to its authority. Having named three Beijing parks where protests would be allowed during the Olympics, the police turned down all of at least 77 applications for permission to hold demonstrations. Among those who applied were two women in their 70s who wanted to complain about inadequate compensation for being relocated from their homes. The authorities responded to their request by sentencing both to a year in labour camp, though the sentences are suspended as long as they behave well.

Officials made strenuous efforts to keep disaffected citizens from other provinces away from the capital during the games. But security is likely to be relaxed after the Paralympics, which will be held in Beijing between September 6th and 17th. The grievances, from land disputes to official corruption, that bring thousands of people to the capital every year in a usually futile search for redress will soon resurface. Even in the security-conscious build-up to the games large riots were reported in several Chinese towns over local abuses of power.

Abroad, China's hospitality (towards those who managed to get visas, at least), lavish spectacles and magnificent new stadiums drew widespread praise. But there will be many doubts about whether all the Olympic bonhomie has transformed the way China sees the world. As China's response to foreign reactions to the unrest in Tibet in March suggested, this can be worryingly xenophobic. The party still sees it as essential to its legitimacy to portray the country as a victim of Western efforts to contain and dismember it.

Tony Blair, a former British prime minister, argued in the *Wall Street Journal* this week that the games would mark a “new epoch”, involving an irreversible opening up of China and a steady decline of “ignorance and fear” of the country. But what many outside China saw during the Olympics was a clampdown on dissent and a disdain even for the spontaneous street-party exuberance of previous games. This will hardly dispel worries about the impact of China’s rise.

Afghanistan

Mournful wake

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From The Economist print edition

Another blow to the war to win hearts and minds

IF AMERICA fails in Afghanistan, as it might, it will be remembered there for killing children. On August 26th the UN claimed to have "convincing evidence" that an American airstrike in western Herat province had killed 90 civilians, including 60 children. That would make it probably the most bloody of America's many murderous airstrikes during its seven-year campaign in Afghanistan. But American officials insisted that only five civilians had died, along with 25 militants.

The bombs struck the village of Azizabad at around 2am on August 21st. American special-forces soldiers, who, alongside Afghan commandos, had been fighting militants in a nearby village, requested them. They thought Taliban fighters were massing in the village. Survivors of the bombing say there was indeed a gathering there—of civilians, for a local man's wake.

When Afghanistan's government first reported the slaughter, an American military spokesman called the claim "outrageous". But the UN's investigation seemed to bear out the government's report. A senior UN official said he was "most confident" in its findings.

Ever since it bombed the Taliban from power in 2001, America has relied on air power in Afghanistan to make up for a shortage of troops. As the Taliban and other militants have gained strength, America has dropped more bombs, killing more civilians. Usually, as in Azizabad, the strikes are called in by American special forces, who are part of a counter-insurgency force that operates independently from Afghanistan's NATO-led peacekeepers.

According to American military figures, civilian deaths in airstrikes increased from 116 in 2006 to 321 in 2007. Over the same period, the number of American air-raids in Afghanistan increased by a third, and the number of bombs dropped doubled. Afghan officials say that in the past two months at least 165 civilians have been killed in four American airstrikes.

Afghans are understandably enraged—which is excellent news for the Taliban. To deflect blame for the latest alleged atrocity, on August 25th several Afghan ministers called for a ban on airstrikes. Hamid Karzai, the president, who has many times pleaded with America to take more care to avoid killing Afghan civilians, wants its troops to be made accountable for any errors they may make.

He may not have his way. But Mr Karzai has, in this case, held their Afghan accomplices to account. He has sacked two senior Afghan army commanders, who were allegedly implicated in passing faulty intelligence to the Americans. The most senior is an ethnic Tajik with close links to Herat's former Tajik warlord-ruler, Ismail Khan. Mr Khan, now Afghanistan's power-and-water minister, was deposed in 2004,

partly due to an offensive by militants in Shindand district, around Azizabad. It may be that American forces were, again not for the first time, unwitting instruments for Afghan score-settling.

For a solution, America’s special-forces men could start by exercising greater care. An American airstrike on another village in Shindand almost a year ago led to a review of both American and NATO rules of engagement. Over the next six months, the numbers of civilian casualties fell, only to bounce back with the arrival of a new batch of American commanders.

It might also help if America’s counter-insurgency force was at least more accountable to its NATO allies. At present it is outside the 53,000-strong peacekeeping force’s chain of command. This will change a bit next month, when General David McKiernan, the NATO force’s American commander, is due to take overall charge of both armies. But the American special-forces fighters will remain under their separate masters, who oversee the Afghan battlefield from Florida.

Pakistan

Man of the hour

Aug 28th 2008 | LAHORE
From The Economist print edition

From demented jailbird to president-in-waiting: Asif Zardari's metamorphosis

AP

Get article background

THE widower of Benazir Bhutto and inheritor of her Pakistan People's Party (PPP), Asif Zardari, is on a roll. He is expected to win the indirect presidential election due on September 6th, having been named as the PPP's candidate this week. For a man accused of massive corruption in his murdered wife's two governments, on account of which he has spent eight years in prison, where his lawyers said he became depressed and demented, this is quite a turnaround.

The presidency became vacant on August 19th, when Pervez Musharraf, Pakistan's ruler for almost a decade, resigned to escape impeachment by the PPP-led government. Mr Zardari had agreed to oust Mr Musharraf, a former military dictator and two-time coupster, largely to placate a quarrelsome coalition partner, Nawaz Sharif, the leader of the Pakistan Muslim League (N), or PML (N). But Mr Sharif, who was toppled and imprisoned by Mr Musharraf in 1999, was not satisfied by this: on August 25th he withdrew his party from the government.

This has reduced the ruling coalition, which includes two small regional parties and a smaller Islamist one, to a slender parliamentary majority. But if, as currently looks likely, Mr Zardari is voted president by the electoral college of the four provincial assemblies and two houses of parliament, it will be bolstered.

Mr Zardari would then inherit the swollen powers Mr Musharraf grabbed for the office, allowing him to appoint provincial governors and service chiefs and to dissolve parliament on a whim. He might also inherit Mr Musharraf's political backers, the Pakistan Muslim League (Q) party. An opportunistic lot, cannibalised by the then-General Musharraf from Mr Sharif's party, they came a distant third in a general election in February, but would give the government a solid majority.

A famous playboy, Mr Zardari was known in the days of Miss Bhutto's governments as "Mr 10%". He was imprisoned, but not convicted, by both Mr Sharif and Mr Musharraf, on charges including murder and corruption. He has been investigated for money-laundering and other crimes in Spain and Switzerland. A British newspaper, the *Financial Times*, reported this week that Mr Zardari's lawyers submitted medical records to a British court last year, claiming he was suffering from dementia and severe depression, and so was unable to appear there on corruption charges. That was one of several cases against Mr Zardari that ran into the sands last year when Pakistan's government withdrew support. At the time, Mr Musharraf was negotiating with Miss Bhutto about a possible alliance. She and Mr Zardari also received an amnesty from corruption charges in Pakistan.

Whatever Mr Zardari's past reputation, optimists hope that the gathering of power in his hands as

president might, just possibly, bring a little more political stability to Pakistan. At the least, it would make the PPP accountable for its handling of the country's twin crises: a plunging economy and spiralling Taliban insurgency, which on August 21st saw a suicide attack outside a munitions factory in the town of Wah that killed 67 people. Hitherto, the government has seemed too absorbed in bickering between the PPP and PML (N) to give much thought to these problems. Indeed, it has had no permanent finance minister since May, when Mr Sharif withdrew his nine ministers from the government.

His complaint was Mr Zardari's failure to honour a promise to restore some 60 judges. They were sacked by Mr Musharraf last November, to prevent challenges to his re-election. Mr Sharif needs some grateful judges, to overturn a ban on his own eligibility for election, and made this one of his two main political demands. But Mr Zardari, who fears that one or two of these aggrieved judges, including their leader, Iftikhar Chaudhry, might review his legal amnesty, was reluctant. In private negotiations with Mr Sharif, he therefore offered to restore all the judges except these possible spoilers. But Mr Sharif, who showed little regard for the rule of law during his own two riotous spells in power, refused to compromise.

In a televised address, Mr Zardari implored Mr Sharif to return to the government. But this is unlikely for now. In a society addicted to the notion of "honour", Mr Sharif's trenchant stance has made him popular. In opposition he may become even more loved: not least because he will now be free to castigate the army's counter-insurgency efforts in the north-west, which are as unpopular as they have so far been hapless. Moreover, with such grievous problems to address, and an untested leader in Mr Zardari, the PPP-led government may well fail; this would be a further boost for Mr Sharif.

But Mr Zardari will also have ways to clip his rival's ambitions. For a start, the PPP might consider leaving the coalition government that Mr Sharif's party leads in Punjab, Pakistan's richest province, leaving it in a minority there. In the 1990s, when Mr Sharif and Miss Bhutto alternated in power, such manoeuvring, viciously pursued, made Pakistan almost as unstable as it is now. Ultimately, this led to the army's takeover, as, in Pakistan's history, political instability always does.

Central Asia and Russia

An old sweet song

Aug 28th 2008 | ALMATY
From The Economist print edition

Russia's Central Asian underbelly rumbles queasily

A CERTAIN tension was in the air as Central Asian leaders gathered in Dushanbe, capital of Tajikistan, on August 28th. They met at the annual summit of the Shanghai Co-operation Organisation, which groups Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan with Russia and China. As in other parts of the former Soviet empire, the region has been shaken by the brief war between Russia and Georgia and the Russian-induced declarations of independence by the Georgian enclaves of Abkhazia and South Ossetia.

Unlike the leaders of Ukraine and the Baltic states, however, Central Asia's presidents have trod carefully. For the most part, they have kept their thoughts on the war to themselves. The notable exception is Kazakhstan's president, Nursultan Nazarbayev. But even he has confined himself to vague public statements and avoided taking sides, though he sent humanitarian aid to South Ossetia.

Government officials and regional pundits agree that a Russian foray into any of the five Central Asian countries (the fifth is Turkmenistan) is highly unlikely. There would be no reason for it. Central Asia has no anti-Russian regimes and joining NATO is not on the cards. Europe is too far away.

Even so, Russia's military humiliation of Georgia and its stand-off with America have unsettled the region. Central Asia's leaders have long learned to live with Russia's view of their countries' role: as a useful buffer to volatile Afghanistan, and as important trading partners and energy suppliers. Equally, however, since the collapse of the Soviet Union, America and China have growing interests and investments in the region. This has helped check any overweening Russian dominance.

Oil-rich and multi-ethnic, Kazakhstan is the economic powerhouse of the region and the Central Asian country with the largest Russian population. Indeed, Russia sees Kazakhstan as such a trusted and strategic partner that President Dmitry Medvedev's first trip abroad took him to the Kazakh capital, Astana (albeit en route to China). But, landlocked and wedged between the huge land masses of China and Russia, Kazakhstan also wants a broad range of foreign links. Of the Central Asian countries, it has the most American investments, and according to its government's statistics is, remarkably, the largest foreign investor in Georgia.

Kyrgyzstan, like Georgia and Ukraine, is a former Soviet republic that has experienced a so-called "colour revolution", which led to the overthrow of its president in 2005. But it strongly sides with Russia. This month an opinion poll found that most of the population would like Kyrgyzstan to have even closer ties with Russia. Hundreds of thousands of Kyrgyzstanis and Tajiks have already migrated to Russia for work to escape their countries' poverty. Yet Kyrgyzstan is in the unique position of playing host to both a

Russian military base and an American one, the latter having been set up for the NATO-led troops of the international coalition fighting in Afghanistan. Observers believe that, at the Dushanbe summit, President Kurmanbek Bakiyev will probably succumb to pressure to close the American base.

Uzbekistan, for its part, shut down its American base over two years ago after being criticised by the American government for a massacre in the city of Andijan in May 2005. It has been a very close ally of Russia ever since. The state-controlled Uzbek press, like that in Turkmenistan, has largely ignored events in Georgia and South Ossetia.

Even if the region need not fear Russian invasion, the war in the Caucasus does pose a threat. As Sultan Akimbekov, editor of the Kazakh magazine, *Kontinent*, puts it, “our region does not want to decide which side to take. We just want to have what we have today.” And, if the confrontation between Russia and the West worsens further, that may no longer be possible.

Angola

Marching towards riches and democracy?

Aug 28th 2008 | LUANDA AND WACO KUNGO
From The Economist print edition

An oil-rich country prepares to vote for the first time in 16 years

Panos

AFTER recent election fiascos in Kenya and Zimbabwe, all eyes are on Angola. On September 5th, 8m-plus registered voters (in a population of some 17m) should cast their ballot to choose a new parliament. They have certainly had to wait for the privilege. Since independence from Portugal in 1975, Angola has had only one multi-party election, in 1992, and it led to a resumption of the horrific civil war that had ravaged the place since independence. The government has repeatedly promised and postponed fresh elections since the end of the conflict in 2002. Only now, it judges, is Angola finally ready.

Decades of war, first pitting Angolans against their Portuguese colonial masters and then against each other, destroyed and traumatised a country that is rich in oil, diamonds and fertile soil. The two sides in the civil war are still the main political parties that will contest these elections: the ruling Popular Movement for the Liberation of Angola (MPLA) and the opposition National Union for the Total Independence of Angola (UNITA). The latter, for many years a rebel movement, gave up arms after the death of its leader, Jonas Savimbi, in 2002. Now led by the articulate and urbane Isaias Samavuka, it has turned into a proper party. Though 14 groups are registered to contest the election, UNITA is still by far the largest opposition one. Incidents still occur in the oil-rich province of Cabinda, but a peace deal signed in 2006 has eased separatist tensions there.

The poll is expected to be peaceful, but, given Angola's long history of violence and one-party rule, the electoral campaign has not been entirely smooth. MPLA backers have attacked UNITA campaigners in several provinces. In power since independence, the MPLA controls all state bodies, including the national broadcaster, the only source of news outside the capital, Luanda. Many Angolans, especially rural ones, are still wary of publicly backing the opposition. The ruling party has been showering favours on local chiefs, who still hold much influence. Human Rights Watch, a New York-based monitoring group, says the elections cannot be fair.

But even UNITA acknowledges that the violence has been isolated and that it has generally been able to campaign freely. The authorities have agreed to hold the vote over one day instead of two, to assuage fears of manipulation. International observers are already on the ground and thousands of independent local ones are being deployed. Opposition parties have received state money to campaign. Though state radio and television spend much time singing the government's praises, they also run advertisements for the opposition and report on its campaign.

Indeed, after being starved of elections for decades, Angolans now face a flurry of polls. The coming vote is expected to be followed by a presidential one next year and local ones in 2010. President José Eduardo dos Santos, in power since 1979, seems to have developed a sudden taste for democracy and says that Angola will now hold general elections every four years. It may be that the ruling party, with the benefits of incumbency, deep pockets and no immediate prospect of losing its grip on power, has decided that democracy is now a safe option.

Even so, it is unclear whether the MPLA will win by a landslide, which would let it mould a future constitution to its liking, or whether it will face a robust opposition in parliament. Pessimists fear that Angola may end up having its de facto one-party state confirmed by the ballot box; but many, including some in the ruling party, are hoping for a more balanced outcome.

Whoever wins, at stake is the future of what may be sub-Saharan Africa's fastest-growing economy. Angola has come a long way since the end of the civil war. Its economy, starting from a tiny base in 2002, grew by 21% in 2007 and may expand by 16% this year. In the past six years, GDP per person, by some measures, has increased several times over.

Oil has been vital. With production at close to 2m barrels a day, Angola is poised to become sub-Saharan Africa's biggest producer, ahead of Nigeria. It has overtaken Saudi Arabia as China's largest supplier. The government is investing a big chunk of its petrodollars rebuilding roads, railways and houses with the help of Chinese, Brazilian and Portuguese contractors. The days of hyperinflation are over, with prices increasing by about 12% in 2007.

The benefits are plain. Cranes and high-rise buildings crowd Luanda's skyline. Swish housing complexes are mushrooming south of the city. New roads try to ease the city's clogged traffic. The port is congested too, with ships waiting often for weeks in nearby waters to dock. Flights are fully booked far ahead. Businessmen have to reserve months in advance to get a decent hotel room. A stock exchange is expected to start up in the next few months.

Waiting for it all to trickle down

Many Angolans, however, have yet to savour the benefits. Oil and diamonds make up 60% of the economy, most of the government's revenue and almost all the country's exports, but these industries do not employ many people. Most Angolans, despite the rise in average income, remain dirt poor. Though the government is busy building schools and clinics, there are often no teachers and doctors to staff them. In overcrowded slums like Boa Vista, near Luanda's port, filthy water mixes with mountains of uncollected rubbish in the unpaved alleys that run between shacks; unemployment and crime are rife.

Much of the opposition's electoral campaign harps on inequality and corruption, whereas the government

prefers to point to new roads and sewerage. Two years ago, it took 16 hours to drive the 420km (261 miles) from Luanda to Waco Kungo in the Kwanza Sul province; lorries often got stuck and could take three weeks. Now, along a new road, it takes five hours.

The government wants to diversify the economy into farms and industry, not only to create jobs but to prepare for when Angola's oil starts to run out. The government itself is investing in agriculture, as in Waco Kungo. A few private commercial farms, often owned by politically well-connected Angolans, have also started up, and foreigners are taking an interest: Chiquita, a banana conglomerate, may invest in Benguela province. Once an exporter of food, Angola now gets most of it from abroad.

Foreign interest is growing apace, but doing business is not for faint hearts. Portuguese colonial administration and years of Marxist management have created a forest of mind-numbing red tape and stifled entrepreneurial spirit. The World Bank says it takes 46 procedures and over 1,000 days to enforce a contract. Angola is near the bottom of the bank's governance rankings. War has left many people with little education, let alone business acumen. The government, directly or through parastatals such as Sonangol, the state oil company, is entangled in much of the economy. Years of central planning dull the minds of the country's host of bureaucrats.

There are signs of progress. Getting approval for an investment is becoming quicker. The government is making its budget and the allocation of oil concessions a bit more transparent. All the same, juicy business opportunities are often restricted to a small elite with links to the ruling party. “In most countries, people get rich in the private sector before going into government,” remarks a local economist. “In Angola, it's the other way round.” Even if these elections turn out reasonably well if not entirely fair, Angola's road to recovery will still be long and bumpy.

Nigeria

Master of his commanders

Aug 28th 2008 | ABUJA
From The Economist print edition

The president shows who's boss

GIVEN Nigeria's long record of military coups, President Umaru Yar'Adua's dismissal of his top military commanders last week might have looked a bit risky—suicidal, even. And, indeed, there were rumours of rebellion in the air. But the fact that Mr Yar'Adua not only removed the officers but calmly left the country immediately afterwards for a pilgrimage to Mecca speaks of a growing confidence among Nigerians that the bad old days of military intervention have finally been laid to rest.

Until recently Africa had a deserved reputation for violent military takeovers, and Nigeria was no exception. Half a dozen coups took place in the three decades or so from 1966 until elections restored civilian rule in 1999. Even then the new president, Olusegun Obasanjo, Mr Yar'Adua's predecessor, was a former general who had previously run the country as head of a military junta. With their aviator shades and shiny epaulettes, the generals plundered Nigeria's vast oil wealth, none more aggressively or brutally than Sani Abacha in the 1990s.

Notwithstanding the new era of civilian rule, there has been little to cheer about for most of Nigeria's 140m people in the past nine years. Elections are still dogged by violence and rigging. Rampant corruption continues to leave roads, hospitals and the national electricity grid chronically underfunded. But the apparent depoliticisation of the armed forces, together with the relative independence of the judiciary, provide some hope that things are slowly changing. The government denied that the departures of the heads of the army, the navy and the chief of the defence staff were in response to any kind of "perceived threat"; it was just a routine shuffling of jobs.

Still, the reshuffle is the latest in a series of attempts by Mr Yar'Adua, a quiet man from a distinguished northern political family, to step out of the shadow of his brash predecessor. A surprising choice as the ruling party's presidential candidate, he was widely seen as nothing more than a puppet, inserted by a disgruntled Mr Obasanjo after he had been denied a third successive term in office. Many Nigerians argue that, along with the boom in mobile phones, an increasingly professional army is one of Mr Obasanjo's more important legacies. The top brass's quiet departure on the orders of the president suggests that this legacy remains safe for now.

"No Nigerian likes the military in government," says 65-year-old Bassey Archibong, a trader who is glad the years of military repression are over. "The poor man may not have seen many improvements" under civilian rule, he said. "But at least you can shout at these people. Shout at the military and they would just kill you."

Zimbabwe

Unspeakably rude to the old man

Aug 28th 2008 | JOHANNESBURG
From The Economist print edition

The opposition scores a telling point

IT WAS a humiliating week for Robert Mugabe. As the new parliament elected in March was convened for the first time, the chairman of the opposition Movement for Democratic Change (MDC), Lovemore Moyo, won the vote to become speaker, beating Mr Mugabe's candidate. Then the veteran leader was booed and heckled during his speech, for the first time in his 28 years in power. Negotiations between the ruling ZANU-PF and the MDC are still suspended, after the two sides failed to agree on who should hold executive power. Mr Mugabe, not one to take humiliation well, looks set to harden his stance: prospects for an early deal look slim. But it was a rare and telling victory for the opposition.

The Zimbabwean leader had violated ground rules, agreed on before the negotiations began, stipulating that the new parliament should not be convened, nor a new cabinet appointed, while negotiations were under way. Several MDC MPs have already been arrested, some as they were entering Parliament to be sworn in. Ahead of a regional meeting earlier this month, Morgan Tsvangirai, the MDC leader, and his party's secretary-general and chief negotiator were both detained at the airport and their passports confiscated en route to the meeting; they were allowed to continue on their way after South Africa's President Thabo Mbeki, mandated by the region's leaders to mediate in the talks, apparently intervened.

Mr Tsvangirai has refused to sign a deal that would leave key powers in Mr Mugabe's hands. A small breakaway faction from the MDC led by Arthur Mutambara is more favourable to the draft agreement, though it said that for now it would not sign without Mr Tsvangirai's assent. But, in the hope of splitting the opposition, the ruling ZANU-PF was instructed to support Paul Themba Nyathi, a member of Mr Mutambara's group, as Parliament's speaker.

The results of the secret ballot indicate that most of the ten MPs from Mr Mutambara's group, together with a few ZANU-PF representatives, voted for Mr Moyo, defying their own leaders' wishes. This could sink Mr Mugabe's attempt to cajole Mr Mutambara's party, which holds the balance of power in Parliament, into a power-sharing deal that would leave out Mr Tsvangirai, even though his mainstream MDC has 100 seats to the ruling party's 99, with one independent MP completing the 210-seat assembly.

Mr Moyo will be able to oversee debates and influence Parliament's agenda. But Mr Mugabe firmly controls the Senate and under the present constitution can rule by decree. He is now expected to form a new cabinet, in violation of the agreement signed with the MDC when negotiations started. In the meantime, Mr Mbeki and the region's other leaders have nonetheless stayed silent.

The Gaza Strip

Ceasefire plus blockade

Aug 28th 2008 | TEL AVIV
From The Economist print edition

Though a ceasefire is more or less holding, Gaza is still under siege

Get article background

DESPITE warnings by Israel's government that it would stop two boatloads of pro-Palestinian campaigners from "breaking the siege of Gaza", the ships, carrying some 40-plus enthusiasts, were eventually allowed to dock safely in Gaza's main port on August 23rd and to disgorge a cargo of medicine, hearing-aids and other items that the local Palestinians have sorely lacked. But, though a ceasefire signed in June is more or less holding and there has been a slight increase in an inflow of humanitarian supplies, Gazans still feel they are virtually under siege.

Since a year ago, when the Islamists of Hamas clobbered their secular rivals, Fatah, in the Strip, the Israelis have restricted the supply of necessities in a bid to make Hamas stop firing rockets at Israel and encourage Gaza's Palestinians to turn against their new rulers. In June, Israel and Hamas agreed to a ceasefire. Since then, the flow of goods has increased, but not enough. The boat campaigners intended to publicise the Gazans' continuing plight.

Since the ceasefire, the blockade has been relaxed but not lifted. Some items—like frozen meat, soft drinks, shampoo and clothes—have become commoner. But Israel still bans goods which it says may be used for making weapons, including metal pipes, fertilisers, batteries and various raw materials for industry and building. The number of lorries entering Gaza has risen sharply but is still barely half the figure before fighting broke out between the Palestinian factions a year ago. As shortages began to pinch, prices shot up—and have barely fallen since the ceasefire. In the last three weeks, imports to Gaza have declined again. This week, as the Palestinian school year began, books, paper and uniforms were all in short supply. Diesel fuel, gasoline and cooking oil are all rare, and most petrol stations remain closed.

Even since the ceasefire began, Israel has closed the crossing points several times, usually after the Palestinians have resumed firing rockets over the border, albeit at a rate some ten times lower than before. Since the truce began, militants have launched some 40 rockets and mortars into southern Israel. Though the makeshift Qassam rockets are seldom lethal, and have caused few injuries, they enrage the Israelis. But Israel has so far refrained from firing back, so the truce is more or less holding. At the same time, Israel is loth to take the pressure off Hamas by letting Gazans enjoy a steadier flow of trade or traffic by land or sea.

Yet neither side wants violence to resume—not, at any rate, yet. Israel has been bogged down in its own politics since its prime minister, Ehud Olmert, said he would not compete in the coming primary poll to choose the leader of his Kadima party, so Israel has a lame-duck government while waiting for him to go. The Palestinians are also tangled up in their own rows. Hamas and Fatah still hate each other; efforts to form another unity government have so far failed.

Despite the edgy calm, a spark could start another blaze. If, for instance, a Qassam rocket were to hit a school, the Israeli government would almost certainly feel obliged to hit back—somewhere, somehow. Indeed, Israel's generals are still preparing for a long-deferred invasion of Gaza, saying that Hamas is using the lull to stock up its arsenal with more sophisticated weapons. It is already thought to have Iran-supplied rockets that could reach Ashdod, Israel's fifth-largest city and main port, some 38km (23 miles) north of the border with Gaza. Ehud Barak, Israel's defence minister, has said that a large-scale clash is inevitable. Israeli generals say Gaza cannot be allowed to turn into a "Cuba", an Iranian-backed outpost in Israel's backyard. If, as opinion polls predict, Israelis elect a more hawkish government, perhaps next year, the chances of a fresh attempt by Israel to change the government in the Strip by a reinvasion may increase.

In any event, despite the fleeting delight of the "Free Gaza" boat campaigners, Gaza still reels under siege (by both its neighbours, since Egypt keeps its own border with the Strip almost completely closed).

Almost none of its 1.5m people can go in or out. Unless their lives improve, they may back a resumption of what they call “resistance against the occupation”.

The two-month-old ceasefire has probably saved the lives of hundreds of Palestinians, both militants and civilians, and a smaller number of Israelis, though vicious factional fighting in Gaza claimed dozens of Palestinian lives at the end of July. But, in many Israeli eyes, the ceasefire has consolidated the rule of Hamas in Gaza, and sent a message to Palestinians that it is the hard men who win concessions from Israel.

It was no doubt in order to change that message that Israel this week freed 198 Palestinian prisoners in a gesture of goodwill to President Mahmoud Abbas, the Fatah leader who runs the bigger chunk of the Palestinian territories, on the West Bank. The hope is that this may boost his flagging fortunes in the battle for popularity among Palestinians. He is still talking to Mr Olmert and to Condoleezza Rice, America’s secretary of state, who has just visited the region again, about her desire for some sort of grand Israeli-Palestinian agreement by the end of the year. For the present, however, the sides remain far apart.

Libya

Time for a new generation

Aug 28th 2008 | CAIRO
From The Economist print edition

Change, if it is on the way, comes in most mysterious ways

HOWEVER much of a mess it has made of Libya, the Qaddafi family certainly puts on a diverting show. Like a television serial with several sub-plots, the drama involving Muammar Qaddafi, who has run his oil-rich state since seizing power 39 years ago, and his eight children, manages to sustain suspense even as the story twists in different directions at once.

For the past few years, a striking sub-plot has been Libya's emergence from the international isolation brought by its involvement in terrorism in the 1980s. This story has now taken a final happy turn with the inking of an agreement with America to settle all outstanding legal claims between the two countries. A compensation fund, likely to be filled by a mix of Libyan oil money and "donations" from big American firms keen to do business with Libya, will now pay the remaining compensation to American victims of the PanAm aircraft blown up over the Scottish town of Lockerbie in 1988 and for other Libyan-sponsored attacks, as well as for 40-plus Libyans killed by an American bombing raid in 1986 in retaliation for an earlier terrorist incident.

The deal opens the way to a full restoration of diplomatic ties, severed in 1980, and marks the final stage of a process begun in 2001 to reintegrate Libya into the international community. The American secretary of state, Condoleezza Rice, is expected to visit Libya in September, the first such visit by so senior an American diplomat since 1953. Though American qualms linger over Libya's nasty treatment of dissidents, the step is seen as a necessary reward for Mr Qaddafi's close co-operation in fighting jihadist terrorism and his decision in 2003 to dismantle a programme to develop nuclear and chemical weapons.

Another long-running drama involves a challenge to the elder Qaddafi from his urbane son, Seif al-Islam. A 35-year-old engineer who dabbles in painting and espouses such causes as environmentalism and human rights, he has emerged as a champion of a different vision for Libya, which most Libyans heartily agree has been dreadfully mismanaged under the dictatorship disguised behind his father's quirky ideology of "direct democracy".

Some of the younger Qaddafi's initiatives have had a degree of success. Like his father, he has held no official position. But Engineer Seif, as he is known, has been credited with solving such tricky issues as last year's release of Bulgarian medical workers, whom the Libyan authorities had jailed on charges of infecting hundreds of children with AIDS. He has promoted freer public debate, financing Libya's first privately owned newspapers and television stations, and encouraging the return of exiled dissidents. He has also been careful to shield his father from direct criticism.

Yet, despite the easing of blanket censorship, the passage of some market reforms, surging state earnings from oil and a growing openness to the outside world, the government is still chaotic, oppressive, and opaque. In recent speeches, Seif has sounded increasingly impatient with the slowness of change; many Libyans think he had begun to tread on important toes, including those of some of his siblings. In a wide-ranging address to thousands of youths on August 20th, he decried the "forest of dictatorships" characterising the region and the tendency for sons to inherit their fathers' throne. He then stunned the audience by declaring that he planned to step aside from politics.

But was he genuine?

Opinions divide over what prompted this move. Made cynical by decades of the older Qaddafi's antics, many Libyans think his son's abdication a stunt. They point as evidence to the eruption of "spontaneous" demonstrations in Libyan cities, where protesters have pleaded for the elder Qaddafi to intervene and persuade his son to return to the fray. Others take the younger man's decision more seriously, as a sign that his lower-profile younger brother, Mutasim, a powerful figure in Libya's security agencies, has

quietly moved to demote his would-be reformist brother.

The suspense may not last long. Qaddafi père is due to make his annual rambling speech on September 1st, the anniversary of the coup that brought him to power. Libyans will be looking for clues as to which son may win his blessing. One sure thing is that it will not be the fifth one, Hannibal. In another running sub-plot, he was arrested in July, yet again, in embarrassing circumstances, while on holiday in Europe. After previous brushes with the law in Britain, France, Italy and the Netherlands, he was charged in Switzerland with beating up two hotel servants.

Russia and Georgia

Put out even more flags

Aug 28th 2008 | MOSCOW
From The Economist print edition

Russia's recognition of South Ossetia and Abkhazia will reverberate for a long time—not least at home

AP

A FEW months ago Dmitry Medvedev, Russia's new president, did not think he would be recognising the independence of two separatist regions of Georgia and heading into direct confrontation with the West. When he met Georgia's president, Mikheil Saakashvili, in St Petersburg in June, both seemed happy. War did not feature in Mr Medvedev's plans; he was even considering an early visit to Tbilisi. But when the two leaders met again in early July, the temperature was far chillier. The night before, South Ossetian and Georgian forces had exchanged fire. Mr Medvedev never made it to Tbilisi: instead Russian tanks poured into Georgia.

Did Russia's security chiefs fear that the two presidents might agree on something that would spoil their long-planned conflict? Did Vladimir Putin, Mr Medvedev's patron and prime minister, crave a small, victorious war? Or did Mr Saakashvili think Mr Medvedev was too soft to respond to Georgia's attempt to regain control over South Ossetia? The answer may never be known. But after barely 100 days in office, the soft-spoken Mr Medvedev was cast in the unlikely role of war leader.

His initial job appeared to be as Mr Putin's spokesman. But he quickly got a taste for war. This former lawyer may have been overcompensating for his civilian background. At any rate, on August 26th he stood beneath the two-headed Russian eagle and solemnly announced the Kremlin's decision to recognise the independence of Abkhazia and South Ossetia. A day earlier the Russian parliament had demanded that Mr Medvedev do just that.

Mr Medvedev said he had no choice and had to protect human lives. The decision, he argued, was forced on him by Georgia's aggression and "genocide" against South Ossetia. But the argument is spurious. It is true that, in the early 1990s, when Georgia was barely a state, its nationalistic leaders (one military commander is still hiding in Russia) committed atrocities in South Ossetia and Abkhazia. But it is also true that more than 200,000 Georgians were driven out of Abkhazia in a burst of ethnic cleansing, and that Russia backed Abkhazia militarily.

Abkhazia had the trappings of a nascent state, but South Ossetia was a chessboard of villages (Georgian and Ossetian) which suffered under a Moscow-sponsored, thuggish and corrupt regime whose main job seemed to be to provoke Georgia. Mr Saakashvili made mistakes: he was in too much of a rush to take back the enclaves and did too little to disown Georgia's nationalist past. His worst mistake (which he does not admit to) was to order the shelling of Tskhinvali, South Ossetia's capital, on August 7th. But this was not, as Russia claimed, genocide; the death toll was fewer than 200. Moreover, the ethnic cleansing of Georgians in South Ossetia is all too evident: Georgian villages have been destroyed and thousands of Georgians displaced by South Ossetian militia under Russia's watch.

If Russia had really wanted to resolve the separatist conflicts in Georgia, it had opportunities. It might have begun by not handing out Russian passports and then claiming a purported need to defend its "citizens". It might also have avoided unleashing anti-Georgian and anti-Western hysteria in the Russian media.

And although the latest conflict was triggered by Georgia, the deeper roots of Russia's invasion lie in domestic events that go back as far as 2003-04: the destruction of the Yukos oil company, and Russia's perception of the colour revolutions in Georgia and Ukraine as a Western plot to undermine its sovereignty. Mr Saakashvili's support for Ukraine's orange revolution particularly irked Mr Putin.

Lilia Shevtsova of the Carnegie Moscow Centre argues that the political system built by Mr Putin requires the images of an enemy and a besieged fortress. "This war is not about South Ossetia, Abkhazia or Georgia," she says. "It is about the matrix of the Russian state and its survival. The beast needs feeding." Konstantin Zatulin, a Duma deputy handling relations with former Soviet republics, is more belligerent. "The time when we needed Western applause is over," he says. "Mikhail Gorbachev made military and political concessions to the West: he agreed to the unification of Germany and the liquidation of the Warsaw Pact but a few years later the country where he was president fell apart."

After years of cultivating xenophobic sentiment and persuading Russians that they face an enemy, the Kremlin had prepared the population psychologically for war. That, says Boris Dubin, a sociologist, is why Russia's propaganda fell on fertile ground. In the public mind, he claims, the cause of the war is to be found in "America's expansionist plans and desire to establish control over Russia's neighbours."

In practice, Russia's recognition of the two territories may not change much. Russia already had almost full control over South Ossetia and Abkhazia and dealt openly with its self-proclaimed presidents. Few countries will follow Russia's recognition. With its troops still in Georgia, Russia has also made a mockery of the French-negotiated ceasefire that demanded their withdrawal to pre-war positions and an international discussion about the enclaves. But overall the war has cemented the victory of isolationist ideology in Russia, which will shape both domestic politics and foreign relations for years to come.

The partition of Georgia may cause a long-term confrontation between Russia and the West, with echoes of the cold war. Too bad, Mr Medvedev said this week: "Nothing scares us, including the prospect of a cold war…we have lived in different situations and we will survive." ("If it's only cold, that's not a problem," Bernard Kouchner, the French foreign minister retorted.) Russia's elite is convinced that the West is weak and will swallow Russia's decision. "When you cross the road you have to check for dangers," declares Mr Zatulin. "The West can apply psychological pressure. But Europe cannot afford to turn down our gas and America needs our help with Afghanistan and Iran."

The fallout may be felt most inside Russia itself. Hopes for liberalisation and modernisation under Mr Medvedev have evaporated. In the past few days the Kremlin has rejected Mikhail Khodorkovsky's parole application, refused to grant Russian citizenship to an investigative Moldovan journalist from Russia and briefly detained protesters in Red Square who held a banner "For Your Freedom and Ours" in a repeat of a

protest against the invasion of Czechoslovakia staged by dissidents 40 years ago. Views once considered extreme are creeping into the mainstream. For example, Alexander Dugin, a nationalist ideologue, greeted events in Georgia by celebrating the removal of the previous “masks”. “We are at war,” he proclaimed. “Now the country should fight not only against its external enemies but also with the fifth column. Pro-Western liberals ...should be interned. War is war. The time of patriots is coming: the time for revenge for all the humiliation from these people that we have been suffering for years.”

Mr Medvedev’s recognition of Abkhazia and South Ossetia may also have unpredictable consequences for Russia’s north Caucasus. Russia has bolstered separatism in Georgia but crushed it brutally in Chechnya. “Talking about the right for independence, about genocide and the war crimes of Mr Saakashvili, Russia’s leaders are perhaps forgetting about the tens of thousands of civilians who were killed by Russia’s bombardment of Grozny and who were executed, cleansed and tortured by the Russian military in Chechnya,” says Ekaterina Sokiryanskaya of Memorial, a human-rights group.

Indeed, Russia’s recognition of South Ossetia and Abkhazia could easily reignite separatist sentiment in the north Caucasus. Chechnya may be too exhausted to fight another war with Russia at present, but in ten years’ time “the question of independence of Chechnya will arise again,” says Ms Sokiryanskaya. Russia maintains stability in the Caucasus by military force and fear. Even as Russia was “liberating” South Ossetia, its security services were intimidating human-rights activists in Ingushetia and Dagestan. The methods they use differ little from those of the separatists and terrorists they are fighting. Inevitably, this leads to further radicalisation of the population, says Magomet Mutsolgov, a human-rights activist in Ingushetia.

Mr Mutsolgov says the war in Georgia found little support in Ingushetia, not long ago engaged in a bitter ethnic conflict with North Ossetia. Rather, Russia’s actions in Georgia have created a general sense of injustice, says Mr Mutsolgov. “What about the thousands of Ingush who have been forced out of their homes by Ossetians?” Many Ingush refused to fight in Georgia. “People here say ‘it is not our war’ ”. The seeds of many conflicts in the Caucasus, as of Russia’s own problems, were planted by Stalin’s ruthless nationalist policies in the 1930s and 1940s. Today’s Russia is planting new ones.

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Georgia and the Balkans

Parallel bars

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From The Economist print edition

Serbia and Kosovo ponder their positions after the war in Georgia

RUSSIA'S road to South Ossetia went through Kosovo. Or so many Russians and even some Western diplomats believe. It has become commonplace to assert that Russia's invasion of Georgia and its recognition this week of the independence of South Ossetia and Abkhazia flowed directly from Kosovo's declaration of independence from Serbia in February, which was recognised by many Western countries. The parallels are superficial at best, but they have led to new calculations in Serbia and Kosovo over which stands to gain or lose the most from the war in Georgia.

Russia has long supported Serbia's claim that Kosovo, 90% of whose 2m people are ethnic Albanians, has no right to independence. The reasoning is that it was a province of Serbia and not, like Montenegro, a republic in the federation of Yugoslavia. Only former republics within the old communist federations, together with the two parts of former Czechoslovakia, have become independent since 1989. Yet America and 21 out of 27 European Union countries have endorsed Kosovo's independence.

Now the West and the Russians seem to have exchanged arguments. Sergei Lavrov, Russia's foreign minister, says that the world can forget about Georgia's territorial integrity, whereas Western countries are demanding that it be respected. With their patrons apparently flip-flopping like this, it is no wonder the authorities in Belgrade and Pristina feel embarrassed—and that both have been largely mute over Georgia.

An early test will come on September 17th. A United Nations committee will decide whether to put on the agenda of the UN General Assembly a Serbian motion to request from the International Court of Justice an opinion on the legality of Kosovo's declaration of independence. If the motion were proposed, Serbia would need only a majority of those voting to get it passed.

The Russian action in Georgia "may have helped us", claims one senior Serbian official, noting that many countries agnostic about breakaway states were frightened by Russia's war. Or maybe not, retorts Lulzim Peci, a Kosovar foreign-policy analyst. Since Russia backs both the motion and self-determination for the South Ossetians and Abkhaz, it may seem no more than a cynical manoeuvre, "because Russia's claim to be helping Serbia will no longer seem like a matter of principle but rather like a political game. Russia has now lost credibility."

Serbian sympathies have always lain with Russia because of its support over Kosovo. But it is clear to

Serbia's leaders that they are to some extent in the same boat as Georgia. However, Veton Surroi, publisher of Kosovo's main daily, insists that, if one wants comparisons, "we are Georgia". He argues that since Kosovo is independent, the Serb-run north of the country is the new potential breakaway, no longer Kosovo itself.

France and Afghanistan

To stay or not to stay

Aug 28th 2008 | PARIS
From The Economist print edition

The debate over whether to keep French troops in Afghanistan heats up

"THE era of easy foreign missions is over," declared France's senior general, Jean-Louis Georgelin. "We are witnessing a return of missions of war." To British or American ears, grimly accustomed by now to the return of body bags from faraway places, the general's remarks were commonplace. But the French are still reeling from the loss of ten soldiers in an ambush in Afghanistan on August 18th, their worst death toll in a single attack since the bombing of a French barracks in Beirut a quarter-century ago. President Nicolas Sarkozy has now brought forward a parliamentary vote on whether to keep extra French troops in Afghanistan to an extraordinary session to be held on September 22nd.

Under France's new constitutional rules, Mr Sarkozy must secure parliamentary backing for any French military operation abroad that lasts for more than four months. He recently sent an additional battalion of 700 soldiers to join the existing ones in the NATO force in Afghanistan, and their continued presence will need parliamentary approval. The reason Mr Sarkozy has chosen to bring forward the vote is a sudden political chorus of concern about the risks and merits of putting more French lives at risk.

Politicians from all sides are well aware of the fact that sending more French soldiers to Afghanistan was unpopular. In April, when Mr Sarkozy decided to do it, 68% of respondents told BVA, a polling group, that they were against the idea. The Socialists even called (and lost) a vote of no confidence to protest at a "strategic alignment" with America. Now, after the recent deaths, fully 55% of respondents have told CSA, another pollster, that they favour a withdrawal of all French troops.

Yet Mr Sarkozy is highly unlikely to lose the vote next month. Despite concern in many quarters, most of his party, which has a solid majority, will back him. Perhaps the most vocal advocate of a pull-out is Olivier Besancenot, a minority figure on the far left. The Socialist Party is tied in knots by an internal leadership battle and also, as usual, split. Its former leader, Lionel Jospin, backed French participation in the NATO force in Afghanistan after the September 11th 2001 terrorist attacks. Even now, despite siren voices urging it on, the party is not calling for a withdrawal. It is critical, rather, of what many see as slavish obedience to an American-led mission over which it has little influence, and of the "military impasse" there. "France has to make its particular voice heard," pleaded Pierre Moscovici, the Socialists' foreign-affairs spokesman, this week, "which is not that of the United States."

Mr Sarkozy has two specific challenges if he is to stop the public's spirits sagging even further over Afghanistan. The first is to answer questions about military preparedness. Many of the soldiers killed, almost all aged between 18 and 22, had recently signed up and only just arrived in Afghanistan. The French commander on the ground, Michel Stollsteiner, conceded to reporters that the unit surprised by the ambush suffered from "over-confidence". In a parliamentary hearing this week in Paris, Hervé Morin, the defence minister, said he was considering sending drones to bolster intelligence there.

The second, broader task will be to persuade the French of the general interest in participating in the NATO operation, despite the risk to soldiers' lives. The media have reported relatively little about NATO's trials in Afghanistan, and the public seems surprised to learn how perilous the situation there has become. There was debate in Paris this week about whether to call the French engagement a "peacekeeping" mission—or simply "war".

In his speech to the diplomatic corps on August 27th, Mr Sarkozy dwelt on the need for France to stay to

fight a “just cause” and help to protect itself from global terror threats. He argues that France can maintain credibility as a world actor only if it pulls its weight. He made clear in his lightning visits to Kabul and to the base in southern France that lost many of the soldiers that he is committed to keeping French troops in Afghanistan, and that it was right to boost their numbers. “If I had to do it again,” he concluded, “I would”.

The Italian public sector

Idlers under attack

Aug 28th 2008 | ROME
From The Economist print edition

A reformer takes on Italy's bloated public sector

LIKE many an Italian state employee, Walter Schiavi awarded himself extra leisure time by faking an illness. On July 30th he was officially in bed with 'flu. In fact, say the police, he was at his workplace—to rob it. On August 21st they arrested the 29-year-old Milanese postman, claiming he was one of two men who had held up the post office where he worked on a day he was supposedly sick.

His case is exceptional only for its picaresque twist. Absenteeism among public employees in Italy is a plague. According to a recent book*, it is four times higher in the public sector than in private companies. In 2005 state workers took an average of 18 days' sick leave. In the health service, the figure was almost six weeks. Every Italian has a favourite story: the professor who gave less than 30% of the lectures in his courses; the judge, unable to sit or stand for long periods, found to be ocean-yacht racing. It would be funnier if the inefficiency of Italy's 3.5m-strong public sector were not such a drag on the economy.

Renato Brunetta, the public-administration minister in Silvio Berlusconi's conservative government, reckons that reforms to the public sector could add as much as 0.5% a year to economic growth. Unlike many predecessors, he is making changes in defiance of Italy's trade unions, whose power is rooted in the public sector. "I refuse to believe the trade unions of today's Italy still want to defend [a] million layabouts against the 60m members of the public who want to see merit rewarded and skivers punished," he said this month. He has imposed by decree a rule that, after the second absence in any year, only medical certificates issued by the public health service will be acceptable. Now he plans to introduce productivity bonuses based in part on attendance records.

The 58-year-old Mr Brunetta is a rare beast in the colourful menagerie of the government: a committed free-market liberal. Excluded from Mr Berlusconi's 2001-06 administration, he spent five years grinding his teeth in frustration over its reluctance to pursue structural reforms. In true Thatcherite style, he comes from modest origins (his father was a Venetian souvenir hawker), which makes him a tricky opponent for the unions. "The rich can afford private services," he said recently. "It is the poor who need efficient state schools and hospitals."

It will take more than a clampdown on malingering to achieve that. But his new rules on absenteeism were accompanied by 24 other reforms, including scrapping small, uneconomic departments, restrictions on the hiring of consultants and measures to stop public employees doing more than one job. More fundamental changes have been proposed in parliament. The big test will come this autumn, when the new reforms come up for discussion just as the unions press for higher pay in next year's budget. Over the past six years, wages have risen by 15% more in the public sector than in private firms. This year the government vows to peg the increase to an unrealistically low inflation target. The stage is set for a mighty clash—and the risk is that the government may sacrifice public-sector reform to win concessions from the unions over pay.

For the moment at least, Mr Brunetta can gloat over figures showing that absenteeism among state workers has plummeted. The July figure was 37% down on a year earlier. Appropriately, one of the sharpest falls was at the labour ministry.

* "Fannulloni d'Italia" by Davide Giacalone.

German recreation

An affinity for rules?

Aug 28th 2008 | BERLIN
From The Economist print edition

Germany has a grip on the business of inventing brainy new board-games

TO SERIOUS gamers Puerto Rico is German territory, not American. They assemble in groups of three to five to plant crops, ship goods and raise edifices, compressing into a cheerful hour or two the wheeling and dealing that consumed the careers of 16th-century colonists in the Caribbean. "Puerto Rico", ranked the second-best board-game by users of boardgamegeek.com, is the brainchild of Andreas Seyfarth, a civil servant, one of a handful of game designers who work in cardboard rather than silicon.

Germany is to board-games what Belgium is to chocolate. It specialises in "Eurogames", which emphasise strategy over showiness, downplay luck and conflict, lean towards economic rather than martial themes and strive to keep all the players at the table until the game's end. The cleverest and most prolific inventors, such as Reiner Knizia (who lives in England) are nerdy superstars. Euro (also "German-style") games must not be confused with "Ameritrash" games, which generally involve high drama and employ plastic pieces, though arguing over what the difference is seems to be gamers' second-favourite pastime.

Why Germany has colonised this pacific region of the board-game world is unclear. Heinrich Hüntelmann of Ravensburger, a German game producer, thinks that an affinity for rules may be part of "the German soul". Germans began to acquire the board-game habit with the rise of the bourgeoisie in the 19th century, partly because they were deemed to be good training for young minds. Fritz Gruber, who works for Kosmos, another German outfit, thinks the pastime has proletarian roots; board-games offer cheap entertainment.

A new boom began in 1995 with the release of "Settlers of Catan", another colonisation game, and has yet to peter out. Germany hosts the board-game Oscars, the "Game of the Year", recently won by Mr Knizia's "Keltis", a game involving cards and stone paths, and the "German Games Prize", which usually goes to more complex games (including Puerto Rico in 2002).

Germans are the keenest European players, followed by the French and Dutch. Britons prefer games based on television characters; Italians don't stay at home, says Mr Hüntelmann. In America, where classics like Monopoly dominate, Eurogames still have an avidly geeky following. Unlike Monopoly they demand thought; unlike electronic games, they encourage social interaction, says Paul Unger, a software developer who plays in New Jersey and Connecticut. That can also be a weakness: sometimes they seem too much like work.

Charlemagne

Unity is strength

Aug 28th 2008
From The Economist print edition

There are reasons why European countries find it hard to unite against Russia

Illustration by Peter Schrank

THE European Union will be heeded by Russia only when it speaks with one voice. That was the universal battle cry in Brussels as EU officials and diplomats hurried back from their summer holidays to prepare for an emergency EU summit on the Georgian crisis, called by the current French presidency for September 1st. And faced with the sobering sight of tanks trundling around Europe's backyard, there was equally loud agreement among national politicians that their usual squabbling over the right attitude towards Russia harms the common interests of the 27-member union.

Yet the rhetoric seems largely empty. The summit will certainly see a lot of joint finger-wagging over Russia's recognition of the breakaway Georgian territories of Abkhazia and South Ossetia. There may be more talk of an EU civilian mission to monitor the situation in Georgia (though the idea of an EU military force has been shelved, at least for the moment). But when it comes to the stated purpose of the meeting—to re-examine EU-Russia relations—the 27 leaders will remain divided into several overlapping camps. These include: those who think Russia can and must be engaged as a partner; those who think Russia needs containing; and a larger group of fatalists who think that Russia "has us over a barrel", as one diplomat punningly puts it. The summit is not expected to agree to make any big changes to the status quo, for the simple reason that the various leaders do not agree over whether that would be a good idea or counter-productive.

Does disunity towards Russia hurt the common EU interest? Probably. A November "power audit" by the European Council on Foreign Relations (ECFR), a think-tank, argued that Europe was throwing away what should be its considerable leverage over Russia. After all, the EU's population is more than three times that of Russia, and its wealth more than a dozen times greater. The EU depends heavily on Russian energy, but the flipside is that it is Russia's biggest market for gas (indeed, for all Russian exports). If the 27 EU countries dealt with Russia as one, they would surely have less to fear from Moscow hawks.

The problem is that the ECFR's argument is both true and beside the point, because it is so far removed from the way that individual countries act and think (reminiscent, in this respect, of the French statement issued after the Olympics proclaiming that the EU had collectively won, with a total of 280 medals). The cold calculation of national interests is a complex business, as any student of game theory can tell you. Disunity would be irrational if EU members always saw their common interests as paramount. But they do not, certainly when it comes to dealing with big third countries, from Russia to China to America.

In Europe, it is rarely enough to show that the union, in aggregate, will gain from a given policy. One must also show that the overall European gain manifestly outweighs individual national interests. This may seem a shabby calculation, but it has democratic roots. The EU is not a single country, whose most senior leaders are elected by a single electorate. In its highest decision-making body, the European Council, the 27 heads of state and government remain accountable to 27 different sets of voters.

Europeans do not even agree on what unity means. Countries such as Germany, which come closer than most to believing in a common European interest, tend to talk of it in terms of the interests of a majority of EU countries, not the interests of all. In recent disputes that pitted Russia against such countries as Poland or Estonia, a favourite line of German diplomats or politicians was to complain that individual countries had no right to take the wider EU's good relations with Russia "hostage".

Nor do the costs of disunity fall equally. Take energy. It must be in the EU's interests to diversify away from the block's dependence on Russian gas—which is why it supports pipeline projects that would bring in gas from elsewhere. But in each individual EU country the voters expect to have the heating on this winter and the lights on all year as cheaply as possible (nor would they easily tolerate sharing their energy with neighbouring countries in the event of rationed supplies). In recent years, countries from Germany and Italy to Bulgaria and Greece have signed deals that increase the EU's dependence on Russia, and undercut alternative routes. From the perspective of those individual countries, such selfishness probably felt quite rational.

I'm all right, Jacques

American officials often wonder why they seem to take European energy security more seriously than the Europeans themselves. One answer is that not every country has to worry about energy security. Russia may shut off oil or gas deliveries to smaller ex-communist countries for spurious "technical" reasons from time to time. But it has never turned off the taps to Germany or Italy. And plenty of EU countries, from Sweden to Portugal, barely consume any Russian energy.

Will the benefits of European unity ever trump the pursuit of national interests when it comes to Russia? Optimists like those in the ECFR say that a more united Europe still has the chance to prod Russia into being a more reliable partner, wedded to the rule of law, international norms and other virtues. Pessimists say that the EU is unlikely to show much grit and unity until Russian behaviour becomes a lot more threatening.

If Russia starts to act even more recklessly—perhaps by stirring up trouble in Ukraine, which has millions of ethnic Russians, or among Russian minorities in EU countries like Estonia and Latvia—EU members may decide that their individual national interest is to stand up together. Even the largest EU country would not wish to be in a club that cannot look after its own. But that won't happen unless Russia throws its weight around a lot more. Meanwhile weakness, selfishness and division will continue, however many fingers wag in Brussels on September 1st.

Immigration trends

Poles depart

Aug 28th 2008
From The Economist print edition

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The largest wave of immigration in British history is petering out, and may soon reverse. But east European migrants have left a lasting mark

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SUPERMARKET aisles offer amateur ethnographers rich opportunities for fieldwork. American pockets in London can be identified by the Thanksgiving displays in November; sour cherry juice suggests that Turks are close at hand. Now great rows of tinned borscht announce a newer arrival. Recent immigration from eastern Europe has been on a truly grand scale: Tesco, Britain's biggest retailer, now runs a groceries website in Polish.

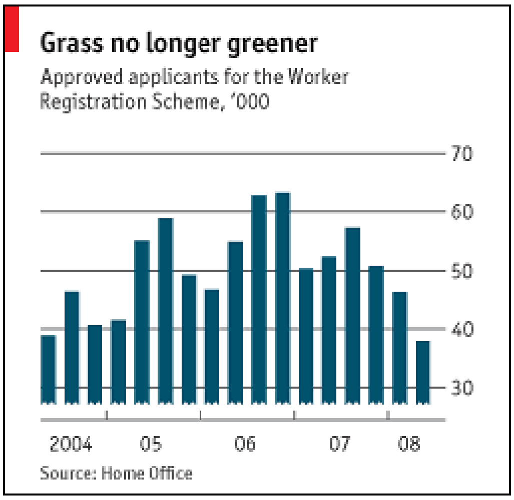
Just over a million people have so far come to Britain from the eight central and east European countries that joined the European Union in 2004. John Salt, a geographer at University College London, reckons it is the biggest influx in British history, at least in gross terms (immigration by French Huguenots in the 17th century may have been bigger relative to the population at the time). Poles, who have made up about two-thirds of the newcomers, are now the largest group of foreign nationals in Britain, up from 13th place five years ago.

They might not be for much longer. The insatiable job market that sucked them in is beginning to tire. Work in hospitality and construction is becoming scarcer in Britain, while Poland's economy is growing by over 5% a year. And earnings do not translate as well as they did: the pound, which bought seven zlotys at the beginning of 2004, now fetches four (see article).

Last quarter saw the lowest number of east Europeans registering for work since 2004 (see chart), even though summer months tend to be the busiest. And as arrivals fall, departures seem to be increasing. There is no reliable official count of the numbers leaving Britain, but in April a think-tank, the Institute for Public Policy Research (IPPR), carried out its own "poll of Poles" and found that about half of the newcomers had already gone home. It predicts that departures will start to outweigh arrivals within a year.

This is bad news for borscht lovers, as well as for the Catholic church, which reckons its numbers have been swelled by some

10% in the past two years, in large part by Poles. But east European migration will leave lasting marks, however brief an episode it turns out to be.



Most noticeably, it has gone some way to decoupling the issue of immigration from that of race. Since the 1950s large-scale immigration to Britain has mainly been from Africa, the Caribbean and South Asia, meaning that arguments about immigration have been racially charged (indeed, plenty of politicians have deliberately conflated the issues). Now, with the arrival of a million white, mainly poor, foreigners, immigration is being analysed in more purely economic terms.

There is a sensible argument to be had about immigration and population (see article), and whether this wave of low-paid workers has put pressure on wages. David Cameron, the Tory leader, has shaken off his brief reluctance to discuss the subject and now casts it in terms of demography. Labour has toughened up too: last year Gordon Brown, the prime minister, called for more “British jobs for British workers,” a rallying cry that once only the far right used. Some critics still touch on the old ugly themes: this month the *Daily Mail* agreed to remove some negative articles from its website following a complaint from the Federation of Poles in Great Britain. But even when the east Europeans have departed, debating the merits of immigration will no longer be off-limits in polite society.

The brevity of the east Europeans’ spell in Britain—if such it proves to be—is the second distinctive thing about it. Past waves of immigrants have nearly always stayed put, or at least aimed to. Unencumbered by visas because their countries belong to the EU, east Europeans do not have to stick around once they are in. Cheap airlines enable some even to split their time between Britain and their home country. This flexibility should give Britain a softer landing if the economy slows further, since migrants can head home rather than swell the unemployment figures. But it has also changed the way that Britons think about immigrants. Once seen as a charge on the state (especially when asylum applications were high, at the start of the decade) they are now more likely to be considered a threat to jobs. Laura Chappell of IPPR has spotted that people tend to describe east Europeans as “migrants”, whereas non-European settlers are called “immigrants”.

Finally, east Europeans have fanned out across the country far more than earlier arrivals, manning Lake District retirement homes, East Anglian farms, Scottish fish-processing plants and Channel Island guest houses. In all, 21% live in London, compared with 41% of other foreign nationals resident in Britain. Their arrival in areas that had little prior experience of migration—Boston, Northampton, Peterborough and others—has exposed problems with how money is disbursed by the central government, and is prompting reform. Funding for public services such as health, police and fire services relies on population estimates, which undercount short-term visitors and those who live at business addresses, such as hotel staff. The government is setting up a (mainly symbolic) pot of about £15m ($28m) a year, funded by a levy on visas, to bail out councils that fall short, and it has promised to improve its counting. More tweaks may follow.

As the Poles pack their bags, those who came to rely on them to paint their walls or fix their computers are feeling the loss. Reinforcements could be on the way: Romanians and Bulgarians will be able to work freely in Britain from 2013 and could come earlier if the economy picks up. But Ms Chappell points out that those countries have strong links with Italy and Spain, and other western European countries have more open labour markets than they did in 2004. Britain may not look as attractive a destination a second time around.

Population changes

Multiplying and arriving

Aug 28th 2008
From The Economist print edition

Immigrants and babies could make Britain the EU's biggest country

IF DEMOGRAPHY is destiny, then the British are roaring forward. On August 27th Eurostat, the European Union's statistical service, predicted that by 2060 Britain would be the EU's largest country, with a population of 77m (compared with around 61m today). Germany, the current top dog, will see its 82m citizens dwindle to 71m over the same period. Britain's boom will be fuelled by a mix of immigration and a comparatively high birth rate (partly a consequence of the higher fecundity of its immigrants).

Besides getting bigger, Britain will also remain youthful, at least by EU standards. Although the share of people over 65 will rise from 16% to 25% by 2060, that will still mean fewer greybeards than anywhere else in Europe except Luxembourg. Eurostatisticians prophesy that Britain will suffer less stress on its pensions and social-security systems than faster-ageing countries. Yet not all Britons revel in the idea of millions of new citizens.

In the wake of enthusiastic migration from eastern Europe from 2004, local councils complained that official underestimates of their populations left them starved of cash and unable to do their jobs properly. And a popular conception that Britain is "full" receives some backing from statistics. Although its overall population density of 251 people per square kilometre is not particularly high for western Europe, England has 392 people per square kilometre, the second-highest density in Europe (behind the tiny Netherlands, with 395). Emigration is at record levels, and anecdotal evidence from firms that help organise departures suggests that feeling life in Britain is cramped is a common reason for leaving.

David Cameron, the Conservative leader, has found talk of overpopulation a useful way to appeal to voters who worry about overcrowding and crumbling infrastructure, as well as to Tories much further to the right than their leader. Others, including the Optimum Population Trust, a think-tank that counts Jonathon Porritt, a government adviser, as a board member, reckon Britain must reduce its population to save its environment and consume fewer resources. It is an argument that plays well at a time of high prices for oil and food.

Such pressure may persuade officials to consider demography in their planning, something that they do only intermittently now, mainly when considering social-security entitlements. But demographic predictions are notoriously unreliable. In the 1940s one projection failed to predict the post-war baby

boom and showed just 35m people living in Britain by 2000. As recently as 2001 British women were having an average of 1.6 children each, a record low. Today that has risen to 1.9, a number not seen for a quarter of a century, for reasons that are still unclear (although immigration plays a part). That much of Eurostat's predicted boom comes from immigration makes it even wobblier, since migration flows depend heavily on economic circumstances, as well as on fickle changes in politics and migration law.

Minority politics

Britain's Obama

Aug 28th 2008
From The Economist print edition

Why a top non-white political leader is some way off in Britain

Illustration by Steve O'Brien

"WE'RE looking at the politics of hope, as opposed to the politics of fear." That sentiment has spurred millions of Americans to support Barack Obama this year in his bid to become president. The words on this occasion, though, were spoken by a Briton. Simon Woolley, head of Operation Black Vote, a campaign group, wants to use Mr Obama's popularity to get Britain's racial minorities more engaged in the political process.

The prospect of a British Obama—a politician of colour who could become a national leader—seems plausible given the racial mix in London alone. But differences between Britain and America explain why it may take a while. Only 8% of Britons are non-white, whereas blacks on their own account for 12% of the American population: the pool from which potential leaders may emerge is smaller. Britain's more fragmented minorities also have less shared political consciousness than African-Americans, whose experience of slavery and segregation produced the zeal behind the civil-rights movement and campaigns for affirmative action.

Different approaches by the state towards identity may also be a factor. Mr Obama has broad appeal partly because he tries to make race less, not more, of an issue. British multiculturalism, with its emphasis on differences, may make things harder for this kind of post-racial politician. America's "melting pot" is of course romanticised: segregation and identity politics are as marked there as anywhere. But the grievances of American minorities are more about exclusion from the mainstream than its imposition on them.

For minority politicians, Britain's centralised political system offers fewer paths to power than does American federalism. There are black mayors of big American cities, such as Detroit and Atlanta, a few non-white state governors (in Massachusetts, or Louisiana) and Mr Obama himself cut his teeth in the Illinois state legislature. In Britain, by contrast, cities as large as heavily ethnic Birmingham lack elected mayors; town halls are famously feeble; and only 4% or so of local councillors are non-white. An unintended outcome of the nascent move towards "localism"—all the main political parties now say more power should be devolved—may be a new generation of non-white leaders.

But structural obstacles don't explain everything. Mr Obama has come as far as he has because of his own talent and determination. Whether Britain emulates his remarkable story depends ultimately on whether a non-white politician of similar calibre pushes himself forward. Only 15 of Britain's 646 MPs are not white but there is some potential among them. Many believe that David Lammy, a Labour minister and friend of Mr Obama, will seek selection as his party's candidate for mayor of London in 2012. Adam Afriyie, an entrepreneur-turned-Conservative MP, has promise. Interestingly, Mr Woolley says it is the Tories who have most actively wooed non-whites in recent years. Labour has become complacent after enjoying strong minority support for so long, say some, and the Liberal Democrats struggle to appeal beyond their largely white strongholds.

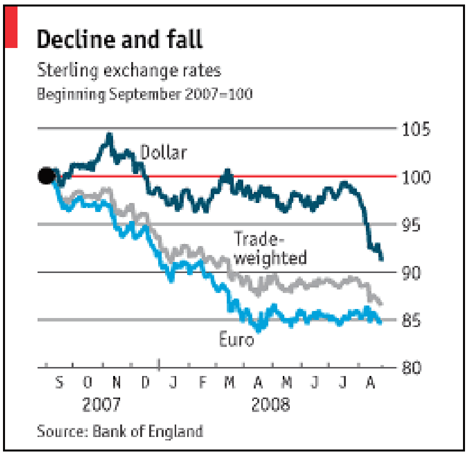
Whichever party produces Britain's answer to Mr Obama, Joe Aldred, a black church leader who talks to national politicians, believes such a figure will come. "I don't think we're as far away from the Obama project as you'd think," he says. "But you need somebody with some courage. More people just need to go for it."

Weak sterling

Vote of no confidence

Aug 28th 2008
From The Economist print edition

The pound's fall is signalling deeper worries about the economy



WHATEVER reassurances ministers may offer about the prospects for the economy, the judgment of the foreign-exchange markets is more telling, for it is backed by money. That judgment is a harsh one. The pound has fallen sharply against the dollar over the past month, closing at $1.84, its lowest for over two years, on August 26th.

Sterling has not been alone in slipping against the dollar. The euro fell almost as steeply during August. But the latest setback to the pound follows a bigger and longer devaluation against the euro that started a year ago (see chart). Altogether, sterling's trade-weighted index (in which the euro has a weight of 54% compared with the dollar's 16.5%) has declined by over 13% in the past 12 months, reaching its lowest point since 1996.

The pound's new bout of weakness has arisen from concern about Britain's deteriorating economic outlook. This took a turn for the worse when the official number-crunchers revealed on August 22nd that the economy had recorded zero growth in the second quarter, rather than expanding by 0.2% as they had previously estimated. The long run of steady growth—63 successive quarters in which GDP expanded—that started in the second half of 1992 has come to an end.

When the Bank of England gave warning in mid-August that the economy would stagnate over the following year, many found the forecast gloomy. Now that it is clear the standstill has already begun, that prediction may prove too upbeat. Capital Economics, a consultancy, is especially pessimistic. It expects the economy to contract in the second half of this year and predicts that GDP will fall by 0.25% in 2009, which would be the first yearly decline since 1991.

The more the economy weakens, the swifter the Bank of England is likely to be in lowering the base rate from its present level of 5.0%. Half of City economists expect a quarter-point cut by the end of 2008, according to a Bloomberg News poll on August 22nd, compared with a quarter of them on August 8th. This is one reason why the pound has slipped against the dollar: international investors now expect lower yields from holding sterling.

As often happens, however, markets may have run ahead of themselves. The further the pound falls, the more this will raise the cost of Britain's imports and add to the surge in inflation, which remains the central bank's main concern. Even excluding oil, prices of imported goods rose by 8.3% in the year to the second quarter of 2008, the highest rate of increase since 1993. This suggests that interest rates are likelier to come down in early 2009, after which consumer-price inflation is forecast to tumble, than later this year, when it will be close to its expected peak of 5%.

But even if rate cuts come later than anticipated the pound is set to remain weak for some time. Consumers, for so long the mainstay of demand, are pulling in their horns and need to save more in order to restore finances debilitated by excessive borrowing. Household spending declined by 0.1% between the first and the second quarter of the year. Fixed investment fell by a hefty 5.3% over the same period. As the engine of domestic demand sputters, the economy will have to rely more upon the efforts of exporters; and they will need the help of a weaker currency, especially as foreign markets slow.

The pound's protracted strength while Labour has been in office reflected an exceptional decade of sustained growth and low inflation. Now that the long boom has ended and harder times have returned, the gloss has been rubbed off sterling as well as the economy.

Buying airports

Ward of the state

Aug 28th 2008
From The Economist print edition

Britain's privatised airports may slip back into public hands

ALONG with cricket and the industrial revolution, privatisation must rank high on any list of Britain's intangible exports that have helped shape the world. Margaret Thatcher's wholesale auctioning of huge parts of the state, from telephones to water utilities, has been widely trumpeted (if less widely emulated) as the cure for all economic ills. So one of the ironies to emerge from plans by the competition regulator to break up BAA, the privatised company which owns Britain's biggest airports, is that the leading bidder for some of its airstrips is itself in public ownership.

Two decades after they were privatised, Britain's main airports are a shambles. Terminals and runways are so overcrowded that flights depart late and bags are lost. Their perennially faulty plumbing has become a point of pride for many visitors from Africa; the lavatories at the airports back home work better.

The Competition Commission reckons that the blame lies in a faulty decision in 1987 to place London's three main airports—Heathrow, Gatwick and Stansted—in the hands of a single company. It now wants BAA to sell two of its London airports, and either Glasgow or Edinburgh.

A number of possible bidders have emerged, including Germany's Hochtief and Fraport, and London City Airport (backed by American International Group, Credit Suisse and General Electric). Analysts reckon that the strongest contender so far is Manchester Airports Group (MAG), which is owned by Manchester City Council and its surrounding boroughs. The group, which plans to bid for two of BAA's properties, now runs not only Britain's fourth-biggest airport but also three smaller regional ones. In London it is likely to bid for Gatwick, whose customers and airlines are more similar to Manchester's than are Stansted's.

There are, however, two obstacles to the bid. The first is money. Although MAG could probably buy a Scottish airport on its own, it would have to team up with an infrastructure investor or sovereign-wealth fund to buy Gatwick or Stansted. Until credit markets uncrunch, finding a partner may be tricky. At the moment many of the most obvious contenders, such as Australia's Maquarie Bank, are sellers of airports, not buyers (see article). And sovereign-wealth funds are looking sceptically at calls for cash after burning their fingers while rescuing banks.

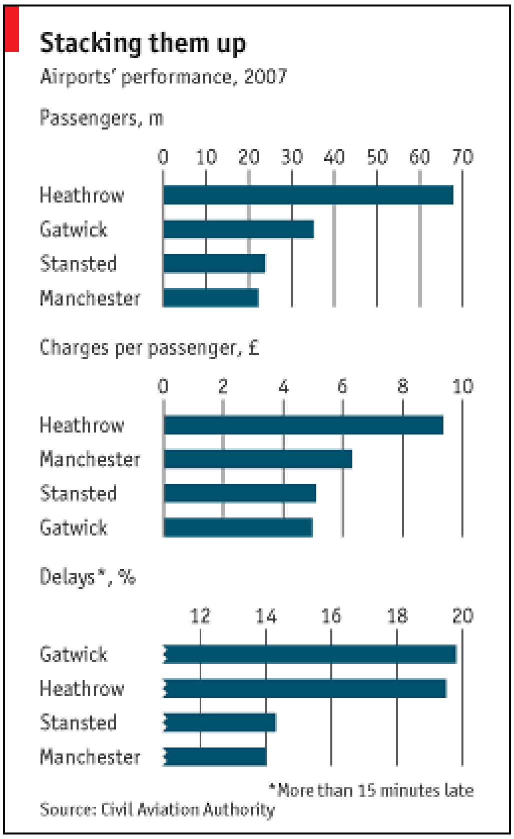
The second obstacle is MAG's public ownership. Some worry that, if effectively placed back in the hands of the state, Gatwick would be starved of investment and continue to bumble along as an overcrowded and shoddy airport that poses no real competitive threat to Heathrow.

Such fears may underestimate just how bracing the winds of competition can be. Until a decade ago Manchester airport behaved much as one might have expected a state-owned utility to do: it was neither especially efficient nor cheap. It charged airlines as much as it was allowed to by a sleepy regulator. When low-cost carriers asked for discounts it sent them packing. All this began to change in 1997, when an energetic building firm bought nearby Liverpool airport and expanded it aggressively by offering cut-price deals.

Since then MAG has made a better fist of running Manchester airport. It has cut its prices, charging less than the regulator's limit, and improved its service. Fewer flights are delayed at Manchester than at the main London airports (see chart), and it fares well in customer surveys.

"I'm terribly suspicious of the public sector," says David Starkie, a

regulatory expert. “But I do hold MAG in high regard these days. They are much more efficient, and that has to do with intense competition from Liverpool.” Perhaps contested markets trump even private ownership in giving consumers a better deal.



Sex education

Never too young to learn

Aug 28th 2008
From The Economist print edition

A debate over introducing the birds and the bees in primary schools

A COMMON complaint about education in Britain is that everything begins too early: four-year-olds start school shortly after abandoning afternoon naps; toddlers barely able to hold a pen are supposed to form letters. Yet one subject, some say, is left too late. Sex education first appears on the compulsory curriculum when pupils between 11 and 14 years old learn the basics in science class; relationships, sexually transmitted diseases and the inadvisability of conceiving in one's teens are relegated to the optional "personal, social and health education". Primary schools need only have a policy on sex education—and for some that policy is "we don't teach it".

Backed by sexual-health and children's charities, a cross-party group of MPs is trying to change all that. In an open letter to the government, published in the *Daily Telegraph* on August 26th, they call for all sex education, not just the mechanics, to be made compulsory, and to start much earlier. That, they say, could help to cut the number of British teenagers who become pregnant: at 40 per thousand girls under 18 each year, Britain's rate is outstripped in the developed world only by America's.

Not everyone, though, is keen on teaching near-babies how babies are made. Primary-school teachers would feel "vulnerable and uncomfortable" if asked to cover such a sensitive subject, says one teaching union. It would "seriously undermine parents", who are the proper source of such information, says the Family Education Trust, a traditionally minded charity. Worse, there are doubts that more, or earlier, sex education would in fact work as billed. An overview of the evidence on the relationship between extra sex education and teenage pregnancy, published in the *British Medical Journal* in 2002 and hotly contested ever since, found that the more meticulous the research, the less likely it was to find any effect at all.

Still, that is not to counsel despair, says Simon Blake, the chief executive of the Brook Advisory Service, a sexual-health charity. High teenage pregnancy rates are not inevitable: even in Britain they are falling, albeit slowly, and in the Netherlands, Sweden and Switzerland, they are less than a quarter as high. The question is how much sex education has to do with the decline. Teenagers are much more likely to become parents if they are poor and ill-qualified, which suggests that improving education in general, not just sex education, would help. "The best form of contraceptive is ambition," says Mr Blake.

But that does not mean earlier sex education might not be justified for other reasons. "It's about teaching communication skills and demystifying the body," says Roger Ingham, a professor of health at Southampton University, "so that as children grow up, they are better able to resist coercion and peer pressure to have sex." He adds: "no one is suggesting four-year-olds should be taught how to have sex."

Even if better and earlier sex education does not cut teenage pregnancy, that doesn't negate its importance, agrees Mr Blake. British parents are often too embarrassed to talk about where babies come from with their own offspring, he says, so some unfortunate children reach puberty before anyone has prepared them for the physical changes it brings. People's earliest sexual experiences set the tone for their future sex lives—which bodes ill for many British teenagers. "If you ask youngsters in the Netherlands why they first had sex, they will say they thought they were in love," he says. "In Britain, they will say they were drunk, or all their mates were doing it, or they had the opportunity and wanted to see what it was like."

The next Olympics

The morning after

Aug 28th 2008
From The Economist print edition

Getty Images

Measures to further sport will work better for the elite than for the masses

WHILE lacking, perhaps, the cohesion of the men's coxless four or the cycling pursuit team who won golds for Britain in Beijing, the unlikely quartet of footballers and pop stars led by Boris Johnson at least managed to accept the Olympic flag from China without dropping it. The whimsy of the British performance at the Olympic handover, featuring twirling umbrellas and a doubledecker bus, suggested that Britain would not attempt to match the pageantry and stadiums that cost China billions. It plans to rely heavily on what London's mayor hopefully calls Britain's "wit and flair".

As far as the sporting competition is concerned, however, Britain will give no quarter. Basking in the afterglow of the country's most successful Olympic games in a century, Gordon Brown has big plans for developing sport in Britain. The prime minister's initiatives include attempts to get more girls involved, funding to give schoolchildren five hours of sport a week and a return to competitive games in schools (on the wane since the 1960s). More money is also expected for community sports facilities.

This frenzy of activity has two aims: to ensure that Britain's Olympians repeat their success in four years' time; and to get a generation of potatoes off the couch and onto the track. The first will be easier to achieve. The British medals in Beijing showed that well-targeted funding allied to greater professionalism brings results, and home advantage will help. But Britain's successful coaches are much in demand elsewhere. And £100m of private-sector funding for elite athletes in the run-up to the 2012 Olympics has yet to materialise, because of the credit crunch.

Inspiring non-Olympians to pull on their trainers is another matter. Research in 2002 by Maarten van Bottenburg, of Utrecht University, found no correlation between the success of a sporting elite and increased public participation in those sports. But taken the other way around, if more people can be enticed to do sports, are world-class athletes likelier to emerge?

Stressing competitive games at school does seem to raise the ambitions and hone the talents of the young: in Australia and Sri Lanka thousands turn out to watch schools do battle on the rugby or cricket pitch, and those countries excel at those sports. In Britain too, schools with money for better facilities produce better sportsmen: private schools educate 7% of Britons yet their old boys (and girls) won 45% of Britain's medals at the previous three Olympics.

So boosting the money for competitive sport in schools would probably produce a few more gold-

medallists (and would have other benefits too). But persuading large swathes of the citizenry to spend less time watching sport on television and more time actually working up a sweat is a Herculean task. As Stefan Szymanski, of City University's Cass Business School, points out, it is harder to build a national sporting culture from the top down than it is to propel a handful of highly talented athletes to the podium. Mr Brown is likely to find that he can bring pools of water to the masses, but he can't make them swim.

Economist.com WORLD BRITAIN

Bagehot

Is tax back?

Aug 28th 2008
From The Economist print edition

The economic downturn has brought taxation back to the centre of political debate—but inside parties rather than between them

Illustration by Steve O'Brien

ONE of the oddities of the New Labour era has been the disappearance of tax (politically, not financially). The public has seemed blithely confident that the share of the nation's wealth taken by government has been more or less correct—even as that proportion has risen by a couple of percentage points. After his three predecessors failed in their bids to beat Labour by challenging that consensus, David Cameron, the Conservative leader, decided to join his opponents instead, abandoning tax levels as an electoral issue. Now, suddenly, tax may be making a comeback.

Gordon Brown will soon embark on his latest relaunch. At its centre will be what some describe as an "economic plan" (though others, wary of inflating expectations, prefer less grandiose labels). The plan (or whatever) seems set to have two main components: assistance for the grim housing market and help with fuel costs for low-income families. Mr Brown is being urged by some in his party to make tax part of the plan too, by, for example, raising rates on very high-earners to fund a cut for the rest. But the idea that has caused most excitement is that of imposing a windfall tax on energy firms—whose tariffs have been rising along with their profits—to pay for a fuel subsidy.

A clutch of union bosses—ie, Labour's paymasters—and a large number of Labour MPs want Mr Brown to pump the energy sector; should Mr Brown and Alistair Darling, the chancellor, resist, resignations are threatened, albeit from very junior government aides of whom few will previously have heard. Never mind that North Sea oil firms already pay a whacking corporate-tax rate, or that a windfall tax might deter investment and perhaps push retail prices higher. Its target ("excessive" profits) and its purpose (keeping poor people warm) look popular. And to some Labourites the proposal is a happy reprise of the levy imposed on privatised utility companies in 1997 (though that was carefully negotiated with the utilities before Labour took office).

For his part Mr Cameron is being newly encouraged—in the Tory blogosphere, and by some party bigwigs—to use his luxurious opinion-poll lead as a chance to be bolder on tax. He and George Osborne, the shadow chancellor, have committed a future Tory government to cutting stamp duty for some first-time homebuyers, raising the threshold at which inheritance tax kicks in, simplifying corporation tax and fiddling with fuel duty. But their main policy on tax is merely to "share the proceeds of growth"—to raise the tax take by less than the rate of economic growth, thus reducing the tax burden over the long haul.

The context of the various urgings, of course, is Britain's sharp economic downturn. The Tories' "proceeds of growth" formula looks somewhat moot now that there is no growth to share. At the same time, with liabilities likely to rise, receipts to fall and borrowing already riskily high, the government is obliged to scratch around for extra revenue that nobody is keen to provide: the public has become grouchier about tax than it was through the long, fat years of Labour's tenure. The time seems ripe for the slashing and squeezing instincts that still lurk in Tory and Labour breasts to burst forth—and for tax to become a defining issue between the parties, as well as a preoccupation within them.

How to spend it

Yet it probably won't, for three reasons. The first is that Mr Cameron and Mr Osborne are avowed fiscal conservatives ("deficit hawks" in American) rather than Reaganite tax-cutters. That stance is partly temperamental, and partly a response to their experiences in the previous two general elections, when Tory tax-cutting pledges were caricatured as irresponsible and callous. Even—especially—in a downturn, Mr Cameron and Mr Osborne prize a reputation for responsible economic stewardship above all. So for all the noises off, there is virtually no chance that they will promise to cut taxes overall. Indeed, Mr Cameron has ruefully acknowledged that a Tory government might be obliged to raise them, as Margaret Thatcher famously did in 1981.

The second reason is that, while some top Tories complain that Britons are at bottom soppy socialists, Mr Brown has always been constrained by an opposite hunch about the British electorate: that it is essentially tight-fisted. (There is truth in both those superstitions: Britons mysteriously combine a European willingness to pay for public services with an American-style scepticism about government.) Thus Mr Brown's long-standing convictions that extra funds must be siphoned off through stealthy ruses, and that redistribution must be conducted on the hush-hush, with the result that Labour gets little credit for the latter, even from its beneficiaries. This ancient allergy to explicit tax increases probably means that Mr Brown will try to resist the advocates of a windfall levy and other high-profile tax hikes. He is likely to opt instead to scrape a little cash together from the energy sector by tweaking the rules for the auction of carbon permits under the European Union's emissions-trading scheme.

The final and perhaps biggest reason why all the talk about tax is unlikely to translate into action is an intellectual failing, one shared by both the main parties. Neither has much that is new to say about the thing that tax pays for: the state.

Mr Cameron and Mr Osborne evince a traditional Tory predilection for a smaller state; for the moment, however, what they propose to shrink is not the extent of the state's responsibilities (or its budget), but the range of services it delivers directly. Their plans for more diverse provision of schools and welfare, for example, have much to recommend them, but they are not likely to save money; indeed, they may cost more. Meanwhile those ministers not resigned to general-election defeat talk punchily about how only Labour can harness the power of Leviathan to meet the challenges of globalisation, but they haven't spelt out how. Before tax can make a proper comeback, both sides need to work out what they want the state to do, or not do, with its proceeds.

Global health

The price of being well

Aug 28th 2008 | NEW YORK
From The Economist print edition

Is it time for a new paradigm for health and development? A heavyweight panel with an egalitarian ideology claims to have found one

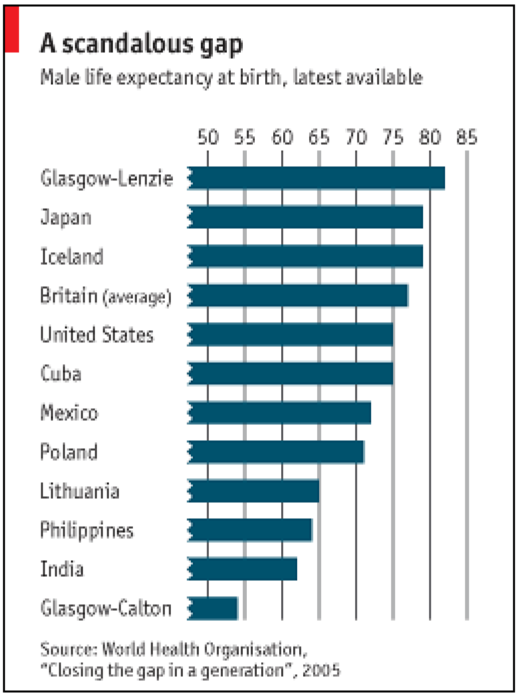
Panos

“SOCIAL justice is a matter of life and death.” Thus begins a long, provocative report released on August 28th by a group of grandees with an impressive range of expertise in health and development. The pundits, who include Amartya Sen, an Indian-born economist and Nobel laureate, were asked by the World Health Organisation (WHO) to take a broad look at the question of inequality and health. After more than two years’ work, the panel has issued a call to arms with a sonorous title: “Closing the gap in a generation”.

Which gap, exactly? That the life of a slum dweller in Caracas is generally shorter, nastier and more brutish than the earthly span of a rich person in Cologne or Chicago is hardly surprising. But why, asks the panel, do men born in Calton, a rough part of Glasgow, tend to die more than two decades sooner (see chart below) than men from the dormitory town of Lenzie a few miles away? Why do America’s Asian females live, on average, to 87, while the life expectancy of black males is only 69? The explanation, according to the WHO’s Commission on Social Determinants of Health, is not merely a matter of income. Nor can it be reduced to the varying capacities of health systems. In addition to those factors, says the report, there are social, political and economic forces that ostensibly have little to do with health but can still end up determining “whether a child can grow up and develop to its full potential and live a flourishing life, or whether its life will be blighted.”

To reduce the risk of the latter, the experts have drawn up a long wish list. They call on governments to improve the quality of everyday life, particularly for women and girls in poor countries, through investment in child care and education, and by insisting on better working conditions. They stress the need to “tackle the inequitable distribution of power, money and resources”—through better governance, support for civil society, and more equitable economic policies. A final element in their proposal to make the world a fairer and healthier place is transparency, and better measurement of progress in tackling inequities in health. The manifesto is a new paradigm for development, claims Sir Michael Marmot, a professor at University College London, who chaired the panel.

Sweeping the proposal certainly is, and the idea of ending health inequality in one generation is ambitious, to put it mildly. But does it amount to anything more than a pious expression of worthy hopes?



At least on a first reading, there are good reasons to take the report with a fistful of salt. First, the authors exaggerate the originality of their ideas; theirs is not an entirely new paradigm. Second, by stressing the "social determinants" of health they may have gone too far to one extreme and underplayed the more obvious link between health and income. And finally, railing against the distribution of power and money may not be much help to anyone who faces practical decisions about how to allocate scarce medical resources.

But for anyone who is willing to look past the report's ideological slant, there are plenty of things in it that deserve to be taken seriously. Ruth Levine of the Centre for Global Development, an American think-tank, describes the manifesto as imperfect but still useful. On one hand, she notes, the report fails to provide any ranking for its laundry list of laudable aims. But it makes a worthwhile point, in her view, by urging a rediscovery of an earlier view of global health that was more prevalent before 2000. That was the year when a different WHO-inspired panel—convened by Jeffrey Sachs of Columbia University—put a controversial emphasis on the way in which poor health leads to bad economic performances by individuals and nations.

With the latest report, says Ms Levine, "we can see the pendulum swinging back." In other words, there is renewed stress on the way that poverty and inequality lead to worse health. Julio Frenk, a former Mexican health minister now working with the Gates Foundation, a charity, says the new report offers a way out of a "sterile debate" about whether poor health causes poverty, or vice

versa. What about the other possible flaw in the new report—that it downplays the link between income (as opposed to inequality) and health? Adam Wagstaff, a World Bank economist, says he still believes income "is causal" when it comes to health—so that faster economic growth is likely to benefit the health of society as a whole, even if income inequality is constant. As an example of the benign effects of money, he cites data from South Africa, where the health of older people improved after they started receiving pensions at the age of 65.

Still, Mr Wagstaff credits the reports' authors with making a nuanced contribution to global-health debates. The authors don't dismiss the role of growth—which they describe as "without question important"—though they do say it can lead to greater inequity unless there are policies specifically designed to improve public health.

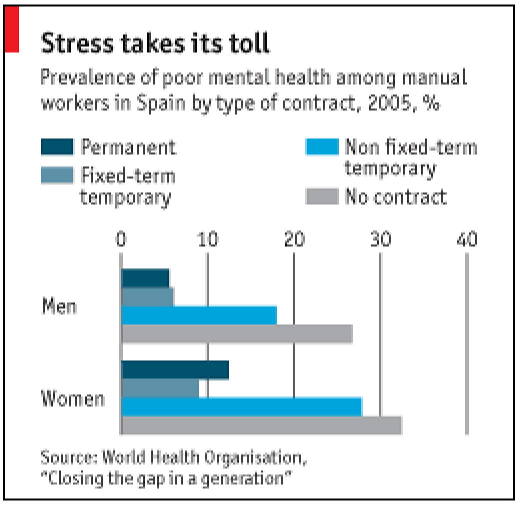
One of the points that emerge from the report has been the subject of a lifetime's research by the panel's chairman. Sir Michael argues that even in rich societies people get healthier as they climb the social gradient in ways that cannot be explained by wealth alone. Hence his interest, and the report's focus, on "social determinants" of health that are non-monetary.

One example: job insecurity, and the resulting stress, have a proven link with mental health (see chart). So does the immunisation of children, even in countries with free and universal access to vaccines. The report lists many reforms—ranging from the extension of social safety-nets to the education of girls and better public information about nutrition—that might boost the chances of better health.

The structure of a country's health services plainly matters too. The commission points out that societies with universal medical coverage enjoy better health than places of comparable wealth that choose a different approach. That gives the citizens of, say, Costa Rica an advantage which many uninsured Americans lack.

But whether people are well or sick also depends on factors and policies that lie far beyond the remit of any health minister. For example, a health ministry may try to get villagers to wash their hands before preparing food, but that is unlikely to happen unless

there is running water, something the ministry cannot control.



The report may be right to look at the full range of causes, broad and narrow, that determine people's physical condition. But it seems, at times, to be baying at the moon when it attacks global imbalances in the distribution of power and money. Especially when you recall that health ministers are often weak figures in a cabinet; they can't hope to change everything.

One other niggle. Amid the report's musings on the social causes of health problems, what about individual choice? A fat glutton can hardly blame a cruel society, or liberal trade policies, for his predicament—yet the report says too little about people's responsibility to look after themselves.

Still, Dr Frenk for one believes it is possible to welcome the report without endorsing the nanny state. He recalls that as Mexico's health minister he successfully made the argument that raising taxes on the sort of cigarettes smoked by the poor would in the long run help the worst off. As he sees it, such a tax need not imply a rejection of choice: diehard smokers can still puff away, but they must pay a price that reflects the cost to society of their habit.

Some people might quibble with his economics. But as Dr Frenk implies, it would be a pity if the new report's saner ideas were obscured by the authors' quixotic determination to achieve perfect political, economic and social equity.

Holy sites

Places apart

Aug 28th 2008
From The Economist print edition

A plan to turn sites of conflict into beacons of peace

AP

Jerusalem: so hard to share

WHEN an army wants to dishearten a defeated foe, few things are more effective than desecrating his holiest shrines. And when a demagogue or warlord wants to make peaceful folk take up arms, nothing works better than telling them that their faith's holiest site needs reclaiming.

And in modern times, fighting over holy places—from India to Jerusalem to the Balkans—seems almost as common as it was in the Middle Ages. During the Bosnian war, over 3,000 religious buildings were destroyed or damaged, including Catholic and Orthodox churches, and above all mosques. In Kosovo, the minority Serbs say scores of Orthodox churches or monasteries have been wrecked by ethnic-Albanian nationalists.

But holy places, even those that are claimed by more than one religion, are not always a source of conflict; there are plenty of cases where a shared holy place has led to a bond between people of different faiths who have divergent beliefs about the site but still rub along.

Hence a plan that was unveiled in Norway this summer to establish a code of conduct for holy sites on which all governments could agree. The code would protect the right of one or more communities to worship at a sacred site; the right of tourists to visit such sites as long as worship is respected; and the right of individuals and groups to manifest their faith at holy places. "We want to turn these locations into places of prayer and reconciliation," says Kjell Magne Bondevik, a former Norwegian prime minister who is also a Lutheran minister and now heads the non-profit Oslo Centre for Peace and Human Rights.

Partners in the sacred sites project include Muslims, Jews and Christians from the "holy land" as well as people from all over the Balkans. It may take a year to hammer out the details of the code—a twinkling of an eye when set against the centuries of war over places.

Pharmaceuticals

Convergence or conflict?

Aug 28th 2008 | NEW YORK
From The Economist print edition

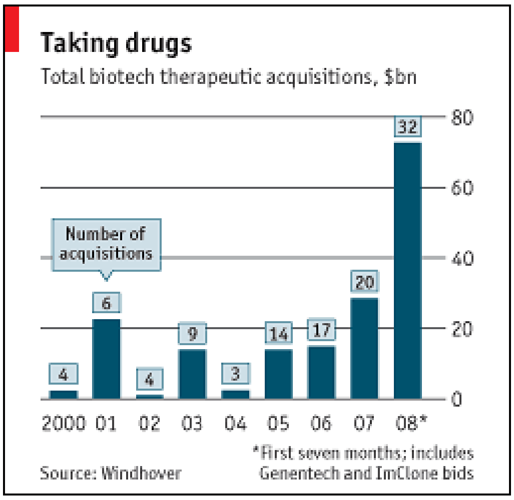
Drug giants' recent attempts to buy big biotech firms have provoked a backlash

Illustration by Claudio Munoz

DALLIANCES between conventional pharmaceutical companies and biotechnology firms are nothing new. Big Pharma, eager to refill its emptying drug pipelines, has in recent years looked hopefully to biotech's upstarts. The drugs giants have pursued all sorts of tie-ups, from alliances to licensing deals to outright purchases of a few smallish companies. But mindful of the sharp cultural differences between the two sorts of firms, they have generally avoided big acquisitions.

Until now, that is. In recent weeks Roche, a Swiss pharmaceuticals giant, has made a surprise $44 billion bid for the 44% of Genentech, the world's biggest biotech firm by stockmarket value, that it does not already own; and Bristol-Myers Squibb (BMS), an American drugs company, has offered $4.5 billion for the 83% of ImClone, an American biotech firm, that it does not already control. These attempts came on the heels of earlier deals in which AstraZeneca, a British drugs giant, bought MedImmune for $15.6 billion, and Takeda of Japan paid $8.8 billion for Millennium.

This frenzy of mergers has been a rare bright spot for investment bankers of late. By one estimate, America saw $60 billion in biotech deals in 2007 and Europe $34 billion. Roger Longman of Windhover, an industry consultancy, notes that the total value of biotech acquisitions by pharmaceutical companies has risen dramatically in the past couple of years (see chart).



What explains the spate of big deals? The familiar underlying problem is that Big Pharma is cash-rich but innovation-poor, so it has resorted to buying in bright ideas while it tries to overhaul its business model. Even so, the industry's new push to acquire large and rather pricey biotech stars is surprising. And the deals seen so far are just the beginning, forecasts Steven Burrill, an industry expert who thinks "the biotech-product 'land grab' by Big Pharma" will soon reach "fever pitch".

Corporate aphrodisiacs

One relatively new factor fuelling the frenzy is regulatory risk. After a series of safety scandals involving Merck's Vioxx, GlaxoSmithKline's Avandia and other problem pills, America's Food and Drug Administration is now decidedly risk-averse. Gobbling up big biotech firms with proven drugs in the marketplace, rather than cheaper but more speculative start-ups, gets around the difficulties of winning regulatory approval for a new drug.

Another motivation may be the looming patent-expiry crisis confronting many big drugs companies. As big blockbusters such as Pfizer's Lipitor go off patent, the industry is about to lose tens of billions of dollars in revenues to generics manufacturers. Biotech drugs provide something of a hedge against this coming calamity, for two reasons. First, they are much harder to copy, so generic equivalents (called "biosimilars") will be slow in coming. Second, big countries including America do not yet have final regulations set up for approving those copycat drugs, thus bolstering the position of the biotech innovators.

The drugs giants also have piles of cash. Although they have shovelled billions of dollars back to shareholders, in the form of share buybacks and generous dividends, they have not succeeded in buying the love of Wall Street, which remains gloomy about the industry's capacity to innovate and worries about possible price-controls on pills. So drugs firms may now have decided to redirect that money into giant acquisitions that could jump-start their innovation machines.

Finally, the weak dollar has made it cheaper for foreigners to take over American firms. Many of today's acquirers are from outside America, but most of the targets are based in the traditional biotech clusters of California and Massachusetts.

Alas for Big Pharma, its courtship of biotech has not been met with open arms. As often happens in May-to-December romances, even a well-financed suitor can encounter resistance from the youthful object of desire. The bosses of both Genentech and ImClone have unceremoniously rejected the offers made by their partners. Some suggest that this is mere posturing, designed to fetch a higher sale price. But there is good reason to think that the fight put up by biotech bosses also has a powerful cultural dimension, too. Many detest Big Pharma, and are convinced that selling out to bureaucratic marketing machines will destroy the heart and soul of their smaller, more agile firms.

Consider Genentech, long viewed as the world's most successful biotechnology firm. Its independent-minded boffins have flourished under the company's famously laid-back approach to research and development. They developed Avastin, a breakthrough monoclonal antibody that already earns $4 billion a year as a cancer fighter, and is on track to become the world's most lucrative drug by 2014. Roche has long recognised the value of that culture, and has wisely remained an arm's length partner to avoid infecting Genentech with its corporate ways.

But the Swiss giant has suddenly changed tack. Why? Trials now under way may, it is said, show Avastin to be a useful treatment for earlier stages of colon cancer than the stages it targets today. If those results, which may emerge in the next few months, are indeed positive, then the drug could be worth many billions of dollars more in annual revenue. So Roche may be trying to grab Avastin on the cheap by swooping before those results come out.

The tussle over ImClone has been an altogether messier affair, thanks to Carl Icahn, a legendary corporate raider who owns a stake and is chairman of the firm. Its main product is Erbitux, a cancer drug jointly marketed with BMS that brings in $1.3 billion a year in sales. Rather than selling the entire company to BMS, Mr Icahn wants it split into two bits: one containing Erbitux and the other inheriting ImClone's future drug-pipeline. He claims BMS used its insider knowledge about his proposal for a split (BMS has its own man on ImClone's board) to make a pre-emptive bid, so it could buy the firm at a cheaper price. He says a break-up would enhance the firm's total value. BMS rejects his allegations and insists ImClone would be most valuable if fully integrated into BMS—a notion that sends shivers down the spines of pharma-haters in the biotech camp.

To see how difficult it can be even for Mr Icahn to get his way, look to the saga at Biogen Idec, another American biotech firm in which the gadfly billionaire owns a stake. He is convinced that the firm would be much more valuable as part of a drugs giant rather than an independent firm. So he pushed it to find a buyer. Biogen Idec's bosses resisted at first, but in the face of lawsuits, boardroom manoeuvring and acrimonious attacks they relented—or so it seemed. Biogen Idec put itself up for sale last year, but the recalcitrant management found clever ways to make the bidding process so onerous and unattractive that nobody made a bid for it.

So will Big Pharma's land-grab succeed, heralding the long-awaited convergence of the two industries?

Given how wealthy and desperate the drugs giants are, some deals are inevitable. But many biotech bosses will not give up without a fight.

Steely logic

Aug 28th 2008 | POHANG AND SEOUL
From The Economist print edition

A steelmaking giant is one of several bidders for a shipbuilder

POSCO, a South Korean firm that is the world's fourth-largest steelmaker, likes to prove its critics wrong. It proudly points out that the World Bank refused to put money into the company when it was founded in 1968, saying South Korea would never be able to support a steel industry. But POSCO prospered and became the engine for the country's remarkable industrialisation. Now the company is trying to convince sceptics that it should buy the world's third-biggest shipbuilder, Daewoo Shipbuilding & Marine Engineering (DSME). A 50.4% stake in the company, worth $7 billion-8 billion, is up for sale.

Prospective bidders had until August 27th to send letters of intent to Korea Development Bank, DSME's biggest shareholder, which owns a 31% stake and is also managing the sale. It is one of the last big asset sales by South Korea's state-owned financial institutions, which took over many companies during the economic collapse of the late 1990s. Since DSME makes submarines for South Korea's navy, the government is not allowing foreigners to bid on security grounds. Along with POSCO, other bidders include Hyundai Heavy Industries, the world's biggest shipbuilder; GS Group, a construction, energy and retail conglomerate; and Hanwha Group, an insurance and chemicals firm.

POSCO's management has been planning the acquisition of DSME for a year. It has deep pockets, with up to $30 billion in credit lined up from its banks. It wants DSME to focus on building more technologically complex vessels, such as offshore oil-and-gas platforms and drilling ships, rather than oil tankers and dry-bulk vessels. And it thinks there is plenty of scope for cost savings. “In building a ship, the less you weld the less you spend,” says Lee Ku-taek, POSCO's chief executive. “If we can tailor our ship plates to a specific ship, then costs can be saved.”

Mr Lee is in charge of a sprawling industrial empire. POSCO has controlling stakes in 20 domestic companies and 43 foreign firms. Its subsidiaries include South Korea's sixth-biggest construction firm, a power company and a computer-services provider. Mr Lee says he wants to increase sales from 42 trillion won ($38.8 billion) this year to 100 trillion won in 2018, and steel output from 35m to 50m tonnes.

As well as planning to expand into shipbuilding, POSCO is looking out for opportunities to acquire steelmakers in Asia. It hopes to begin work soon on a 12m tonne steel-production plant in the Indian state of Orissa, where it also has mineral rights. And next year it hopes to complete the construction of a cold-rolling mill near Vietnam's Ho Chi Minh City, and an automotive steel-sheet plant in Mexico to supply General Motors and Hyundai Motor.

Like other steelmakers, POSCO has sought to acquire mines to insulate itself from the commodity-price boom. The company has stakes in two iron-ore mines and seven coal mines in Australia, but says that prices of mines there and in Brazil make further investment in the two countries unlikely. Mr Lee says the firm is looking to buy mines in Africa, Siberia, Indonesia and Eastern Europe, and has a goal that 30% of its raw materials should be supplied by mines in which it has a stake.

Previously, says Mr Lee, steelmakers competed on the basis of their products. “Companies with better technology had an edge,” he says. “Now it has changed. Companies with mines have the advantage.” Some investors, who are sceptical about POSCO's bid for DSME, agree. They would prefer POSCO to concentrate on buying access to raw materials, as its rivals are. Can the company prove its critics wrong once again?

Business in India

Nano wars

Aug 28th 2008 | KOLKATA
From The Economist print edition

Tata threatens to make the world's cheapest car somewhere else

EPA

Opponents of a Nano state

THE peasantry were a source of disappointment to Karl Marx. Smallholders had about as much collective spirit as "a sack of potatoes", he once complained. The Communist Party of India (Marxist), which has governed the state of West Bengal since 1977, also believes the state's future lies in industry, not just farming. In 2006, as proof of its ambition, it succeeded in luring Tata Motors to the state to build the Nano, the world's cheapest car. But it is facing some spirited opposition.

On August 22nd Ratan Tata, chairman of the Tata group, threatened to move the Nano plant from the state if the company was not wanted. His warning came in response to a mounting protest against the project, which will occupy 997 acres, much of it former farmland, in Singur, about an hour's drive from Kolkata (formerly Calcutta). The plant's tormentors have mustered rallies, blocked roads and even assaulted an employee of a Tata supplier, all in the name of the smallholders who unwillingly lost their land to the project.

The West Bengal government wanted the Nano plant both for the jobs it would bring and the message it would send. Though the state's capital has streets named after Lenin and Ho Chi Minh, its government has opened its arms to private capital. It beat stiff competition from rival states to win the Nano project, which has become a symbol of India's industrial ambitions. "The world is eagerly waiting for this car to come out on the streets," says Nirupam Sen, the state's industries minister.

The government expropriated land for the factory using the 1894 Land Acquisition Act, introduced by the British to build railways and canals, which obliges private owners to part with land required for a "public purpose". Supreme Courts in several American states have ruled that governments cannot expropriate land for private development, but Kolkata's High Court has judged differently. What counts as a public purpose, it has noted, is a "socio-economic question" that should be left to local governments to answer.

Tata could not buy the land itself, Mr Sen argues. West Bengal is a crowded state, which went further than most to return land to the tiller. As a result, landholding is fragmented. Over 13,000 people held claims on the land acquired for the Nano. It would have been impossible for Tata to negotiate with all of them one by one.

Of these 13,000, about 2,250 refused to accept the government's compensation, even though it comfortably exceeded the market rate before the plant arrived. In some cases, the owner's tenure was muddy. But in others, the owners felt genuinely aggrieved, sorry to lose fertile cropland that yielded as many as three harvests a year. These lost acres proved equally fertile grounds for a political fight. The cause was quickly seized by the Trinamul Congress party, the main opposition in West Bengal, led by the tempestuous Mamata Banerjee.

Ms Banerjee wants the government to return 400 acres to those who refused compensation. That would leave room for the plant, but not Tata's suppliers, which should relocate nearby, she says. But her demand cannot be met without losing the project, Mr Sen says. Any extra distance between the mother plant and its offspring will add to the cost of production, he points out, jeopardising the "one-lakh" price tag (100,000 rupees, or $2,300) that has made the Nano famous. Besides, the disputed holdings are scattered throughout the site, and by law, the government cannot give the aggrieved farmers land that was expropriated from someone else.

Tata has already invested 15 billion rupees in the project. But other states are queuing up to welcome it if

it decides to move. The first Nano was scheduled to go on sale as early as October, around the time of the Durga Puja, a festival devoted to a fierce goddess who carries a trident, a sword and other weapons in her many hands. That deadline now looks in doubt, a casualty of Ms Banerjee’s weapons: the *bandh* (general strike), the *gherao* (human blockade), and the *dharna* (fast).

Solar power

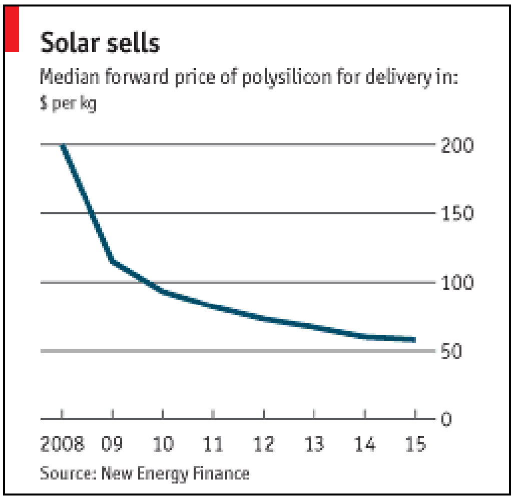
Silicon rally

Aug 28th 2008
From The Economist print edition

One shortage in the solar-panel business gives way to another

FOR 40 years or so, the price of solar panels fell steadily, as volumes grew and technology improved. But in 2004 Germany enormously increased subsidies for solar power, prompting a surge in demand. The supply of pure silicon, the main component of most solar cells, did not keep pace. Its price rose from $25 a kilogram in 2003 to as much as $250 this year, abruptly halting the downward march in the price of panels. If making energy from sunlight is ever to become as cheap as burning fossil fuels, the price of silicon will have to fall.

Happily, it seems likely to do so soon. Silicon producers, whose biggest customers were always chipmakers, have been slow to cater to the solar industry. They were scarred by the memory of the technology bust of 2001, which had weighed them down with excess capacity, and so delayed expansion—despite the boom in solar. Moreover, it takes three years or so to get a new plant going, so new silicon supplies are only just beginning to materialise.



New Energy Finance, a research firm, expects the output of silicon for the solar industry almost to double next year. It has asked big buyers and sellers what prices they have agreed on this year for silicon to be delivered in the future. The responses suggest that participants in the industry expect prices to fall by more than 40% next year, and over 70% by 2015 (see chart).

Other analysts are more cautious. HSBC, an investment bank, expects shortages to last throughout 2009. Cyrus Mewawalla of Westhall Capital, a broker, notes that predictions of silicon prices were notoriously unreliable even when chipmakers were the sole customers; the rise of the solar industry adds another variable.

One source of uncertainty is demand. This may be softer than expected because of cuts in subsidies for solar power in Germany and Spain, and because of the looming expiry of a big tax-break in America. The chief source of uncertainty, though, is on the supply side—in particular, the troubled outlook for a host of planned new plants in Asia. Most observers expect that some of these will never materialise, others will take longer than scheduled to build and many will be less efficient than their backers claim. Earlier this year Trina Solar, a Chinese firm, abandoned plans for a big new silicon plant. Although more setbacks of this kind would slow the price's fall in the short run, says Jenny Chase of New Energy Finance, the construction of a few less efficient, higher-cost plants will eventually create a tier of marginal producers, and so temper future price swings.

Yet even if the silicon price falls, other bottlenecks may well appear. The first step in making solar cells is to shape silicon into ingots and then slice it into wafers. Ingot- and wafer-makers hope a surge in the silicon supply will expose a lack of capacity in their fields. Others wonder whether there will be enough of the specialist chemicals that coat cells. HSBC predicts that the solar industry will grow by 45% a year until 2012. Such searing expansion is bound to cause more growing pains.

Food regulation in America

Menu items

Aug 28th 2008 | NEW YORK
From The Economist print edition

Restaurant chains must now list the calorie content of the food they sell

IN JANUARY New York became the first American city to pass a law requiring restaurant chains to state the number of calories in everything on their menus, right down to the last pretzel. Full enforcement of the new rules began last month. Other cities and counties have since followed. Los Angeles is expected to vote on its own law within the next two weeks. California, meanwhile, is considering a statewide bill.

Fans of menu labelling say it helps consumers, who tend to underestimate the calories in the food they buy. Critics say it is another step towards a nanny state. Companies complain that it is costly to reprint menus, and the National Restaurant Association says restaurants will find it difficult to meet a “patchwork” of city, county and state standards. The New York State Restaurant Association was so outraged by the New York regulations that it sued, claiming infringement of commercial freedom of speech under the First Amendment. The case is now in the New York courts on appeal, and a decision is expected any day.

America’s restaurant industry, which is expected to have $558 billion in sales this year, has vigorously fought menu-labelling legislation. Some restaurants, already concerned about the slowing economy, worry they could lose customers if they draw attention to the number of calories in their food. Already, many New Yorkers have been disheartened to learn what their favourite dishes contain. Marion Nestle, professor of nutrition at New York University and the author of “Food Politics”, says frequent restaurant-goers have found the calorie information “just astonishing”.

It is too soon to say whether menu labelling will reduce sales or prompt diners to order something different. One study, published this year, found that customers ordered foods containing an average of 52 fewer calories when the information was prominently displayed in fast-food chains in New York. Another study found that diners ordered lower-calorie meals when the menu was labelled—but only on Mondays and Tuesdays.

Yet the new rules could also enable restaurants to attract customers, and reduce costs, by tweaking their menus. Many companies have already started to introduce new low-calorie items and serve smaller helpings. Starbucks, for example, has changed its “default” milk from whole milk to reduced-fat milk, cutting the calories in its drinks by 14%. (Reduced-fat milk also happens to be cheaper.) Dunkin’ Donuts has a new lower-calorie line called “DD Smart” that is designed to appeal to the health-conscious with such things as egg-white flatbreads and fruit smoothies. And McDonald’s has reduced the size of a helping of French fries, cutting the number of calories—and costs.

Le Pain Quotidien, a mid-range bakery chain with $165m in worldwide sales and 17 outlets in New York, thinks it has profited by adapting quickly to the new rules. Jack Moran, the company’s vice-president of branding, initially thought it was “frightening” that customers would be able to see the calories in everything on the menu. So he put together a team to overhaul the menu, cutting portions and eliminating items with lots of calories. This has proved, he says, a “strategic advantage” and boosted business. The company is now planning to provide calorie information voluntarily in Washington, DC, and Los Angeles—even though the local laws do not yet require it.

Economist.com BUSINESS

Technology, business and the law

The big data dump

Aug 28th 2008 | SAN FRANCISCO
From The Economist print edition

A deluge of electronic information may overwhelm American civil justice

DAWN BEYE'S teenage daughter suffers from anorexia nervosa and had to be treated in hospital at a cost of about $1,000 a day. Horizon Blue Cross Blue Shield of New Jersey, the Beyes' insurance company, covered one month of the bills but then balked, demanding evidence that the affliction was "biologically based" rather than psychological. So Ms Beye got together with parents of other anorexic and bulimic teenagers and sued. Horizon immediately asked to see practically everything the teenagers had said on their Facebook and MySpace profiles, in instant-messaging threads, text messages, e-mails, blog posts and whatever else the girls might have done online.

The Beyes' lawyer, David Mazie at Mazie, Slater, Katz & Freeman, objected on the grounds that Horizon's demands violated the girls' privacy. He lost. So hard disks and web pages are being scoured in order for the case to proceed. Gathering and then sifting through all the electronic information that a few teenage girls have generated is excessive and daunting, says Mr Mazie.

And yet almost all information today is electronic, and there is ever more of it. "Things that we would never have put in writing are now in electronic form," says Rebecca Love Kourlis, formerly a justice on Colorado's Supreme Court and now the director of an institute at the University of Denver dedicated to rescuing America's civil-justice system.

This system, she says, was already a "sick patient"—with crowded dockets and understaffed courts—but electronic discovery now threatens a lethal "spike in fever". She has seen ordinary landlord-tenant disputes take three years, and divorce cases that might have been merely bitter, but are now digital wars of attrition. She sees cases that are settled only because one party cannot afford the costs of e-discovery: whereas in the past 5% of cases went to trial, now only 2% do. She knows plaintiffs who cannot afford to sue at all, for fear of the e-discovery costs.

For large companies, these costs now run into many millions. Patrick Oot, a lawyer for Verizon, an American telecoms giant that gets sued a lot, says that at the beginning of this decade e-discovery presented "a one-big-case, once-a-year problem". In most cases information was still on paper, and its volume thus limited. In the rare event that electronic evidence was requested, 100 gigabytes (GB) was considered a large amount. Today, says Mr Oot, almost every case involves e-discovery and spits out "terabytes" of information—the equivalent of millions of pages. In an ordinary case, 200 lawyers can easily review electronic documents for four months, at a cost of millions of dollars, he says.

This has led to a new boom industry of specialised e-discovery service providers which merrily charge $125-600 an hour. George Socha, a consultant, estimates that their annual revenues have grown from $40m in 1999 to about $2 billion in 2006 and may hit $4 billion next year.

The process of e-discovery starts when the adversaries in a lawsuit demand to see all sorts of information in their search for relevant nuggets. Each side then has to identify all the laptops, smart-phones, memory sticks, network servers and back-up tapes that might store data created by the people in question. It probably also has to request logs from online-service providers, if those people used web-mail or similar services. The results then have to be indexed and reviewed by humans. This usually falls to the junior staff at law firms, some of whom are so fed up with the drudgery that they have quit the profession altogether.

For firms that find themselves in court a lot, it makes increasing sense to bring this entire process in-house, rather than farming it out. Verizon, for instance, has been using outside firms such as Kroll, but found them "really expensive", says Mr Oot. So Verizon has established a dedicated internal e-discovery group which Mr Oot oversees and which will gradually take over all e-discovery using its own software and staff. Mr Oot reckons this will save Verizon $11m in costs over three years.

But even as huge companies such as Verizon learn to cope, the civil-justice system as a whole threatens to get bogged down. Stephen Breyer, a justice on America's Supreme Court, recently expressed concern that, with ordinary cases costing millions just in e-discovery work, "you're going to drive out of the litigation system a lot of people who ought to be there" so that "justice is determined by wealth, not by the merits of the case."

This is overwhelmingly an American problem. In countries such as France and Germany that have an inquisitorial legal tradition, e-discovery tends to be proportionate to the case, because judges largely determine what information is relevant. By contrast, in adversarial common-law systems, it is the opponents in a case that decide how much information to peruse before picking out the evidence. But most countries within this tradition, such as Britain, Canada and Australia, have recently moved towards inquisitorial systems to minimise the threat from e-discovery.

As a result, American civil law is now "way behind" the rest of the world, says Ms Love Kourlis. New federal rules that took effect in 2006 included guidelines for electronic data. But they have not changed a fundamental aspect of America's brand of adversarial law, which places almost no limit on the information that the plaintiff and defendant may seek from each other.

So Ms Love Kourlis suggests some new rules. Judges in civil cases, she says, need more power to assess and define the appropriate amount of information that can be sought in each case. Civil cases ought to require both sides to disclose what information they have, as in criminal cases, thus ending the game of hide-and-seek that makes both parties ask for more, for fear of missing something. And shifting lawyers away from being paid by the hour (see article) would mean that they no longer had an incentive to add to the process.

Law firms

Killable hour

Aug 28th 2008
From The Economist print edition

Is time almost up for clockwatching lawyers?

Illustration by Claudio Munoz

OF ALL the tedious tasks that lawyers have to do, time-recording is perhaps the most deadly. Private-practice lawyers account for their time in increments of 15 minutes, or even five or six minutes at some firms, and then send the bill to clients. This structure has been in place for decades. But cost-cutting has put a squeeze on companies' legal budgets, and there is growing interest in doing away with the "billable hour" approach in favour of other pricing schemes.

It is not hard to see why. The hourly rate for a newly qualified lawyer at a big firm can reach £235 ($425). Most big British and American firms set targets for all their lawyers, from 1,300 billable hours a year to 1,800 hours and beyond. Lawyers who exceed their targets often get a bonus. But clients complain that this practice values the quantity of hours billed over quality and encourages padding.

If the billable hour does perish, it will be at the hands of the clients, rather than the private-practice lawyers themselves. Some companies are starting to switch to fixed fees, with a performance bonus related to results. Tyco, an American conglomerate, took this approach with Eversheds, a British firm, in a deal signed earlier this year. The firm has taken on Tyco's commercial legal work for a fixed fee, and will receive a bonus if it improves its client's satisfaction by 35% and reduces litigation against Tyco by 15%.

High-volume legal matters, which rely on precedents and templates, are the most obvious targets for fixed fees. Set prices can be put on anything from commercial contracts to trademark filing and personal-injury work.

Litigation is less suited to fixed fees, however, because of its unpredictability. Some firms provide upfront estimates, whereas others charge a "blended fee" based on a combination of hours worked and a fixed fee. In America some companies take a share of the settlement. Wiley Rein & Fielding, a firm in Washington, DC, used this to great effect in March 2006 for NTP, a small firm which won $613m from Research In Motion, in a patent-infringement case over the BlackBerry e-mail device. The firm got $200m, which it shared among all its employees.

Finding a new model to price legal services is no easy task. A lawyer's skill, knowledge and experience are hard to quantify, as is the importance of a legal matter to a company. The fixed fee at least gives in-house lawyers certainty when budgeting and confidence when explaining that budget to the board.

But the legal industry is not known for welcoming change. Whatever it turns out to be, the billable hour's replacement must be easy to use—and must strike a compromise between clarity for the client and profits for the law firm.

Face value

The sage of Quiznos

Aug 28th 2008
From The Economist print edition

The skills of Greg Brenneman, a corporate-turnaround specialist, are in demand

Reuters

A FEW years ago Greg Brenneman was asked to give some advice to MBA students thinking about the next step in their careers. "If you have a chance of working for a healthy company or a sick one," he wrote, "choose the sick one. The sickest ones need the best doctors and it's a lot easier to stand out in a company that needs help." He should know. Throughout his career, Mr Brenneman has gone looking for trouble—first as head of the corporate-turnaround practice at Bain, a consulting firm, and then in a succession of senior roles, including stints at Continental Airlines, Burger King and Quiznos, two American fast-food chains.

Each of these three businesses was going through a difficult time when Mr Brenneman came on board—he described Continental as "the world's worst $6 billion company" before joining it—and at each he applied a similar approach to sorting out its problems. His tactics, which may provide inspiration for those managers whose firms are struggling in the economic downturn, have impressed private-equity partners. On August 19th Mr Brenneman stepped down as chief executive of Quiznos (though he has become its executive chairman) to take up a new role as chairman of CCMP Capital Advisors, a private-equity firm.

As well as helping CCMP do deals, Mr Brenneman will coach executives at firms in its portfolio. "It's back to the future in private equity," he says enthusiastically, pointing out that because cheap finance has evaporated, investors must now concentrate on improving the operations of the companies they invest in. That reminds him of private equity's early days when, he says, "you had to get in and roll your sleeves up and grow businesses."

So what treatment does Mr Brenneman recommend for a sick corporate patient? First, stop it doing things that bleed red ink. Take the case of Continental, which he joined in 1994 as chief operating officer when the company was on the brink of a third stint in Chapter 11 bankruptcy protection. After Mr Brenneman was hired by Gordon Bethune, the airline's new boss, they quickly worked out that 18% of its flights were losing money. Axing these lossmakers helped pull the carrier out of its financial nosedive.

The next step is to come up with a clear strategy—and then stick to it. This is especially important in a crisis, when managers can easily lurch from one master plan to another in pursuit of profit, confusing employees and customers as they do so. Before Mr Brenneman took over in January 2007 at Quiznos, which has more than 5,000 restaurants worldwide, the company was flailing around. Angry franchise-holders had launched lawsuits against the firm and customers were shunning its pricey sandwiches. Revenue growth at many restaurants had stalled.

Mr Brenneman quickly made clear to staff that the priority was to reignite profitable growth. Since then, Quiznos has revamped its procurement to cut raw-materials costs, bolstering franchisees' profits. It has also expanded delivery and catering services, which were offered in only a handful of outlets. This has boosted sales per restaurant, though the privately owned firm refuses to say by how much. In another effort to increase sales, Quiznos stepped up its international expansion: last week it said that it will add at least 500 restaurants abroad over the next two years in countries such as India and Brazil.

Mr Brenneman's turnaround tactics also call for launching new products. For instance, when he became chief executive of ailing Burger King in 2004, he championed the Enormous Omelette Sandwich, a calorie-packed mega-bun that was popular with the Burger King faithful. (He left the company in 2006 having revitalised it in preparation for a flotation.) At the other end of the food spectrum, Quiznos has launched the Sammie, a $2 sandwich that appeals to people who had been avoiding the chain because of the relatively high cost and calories of its other food.

Although new products can be important to a successful turnaround, new managers are absolutely essential. "It's hard for the same people who put you in the ditch to pull you out of it," cautions Mr Brenneman, who admits he has occasionally failed to change top managers quickly enough at some of the companies he has run. At Quiznos he overhauled much of the senior executive team, bringing in fresh blood from the ranks of other fast-food giants, including Burger King.

The doctor will see you now

His recruits have been impressed by another Brenneman tactic. "He's taught me the importance of seizing the airwaves and making clear what the business agenda is," says Dave Deno, Quiznos's new boss. Each Friday the fast-food chain's franchise-holders get a voicemail updating them on the business. Many of these have been left by Mr Brenneman, but occasionally other managers take a turn. The plain-speaking Mr Brenneman likes this because, he says, "if someone gets on a voicemail and promises something to thousands of people, they will do it." All voicemails and e-mails from franchise-holders must be answered within 24 hours. This has helped thaw relations with disgruntled restaurant-owners, though some lawsuits still rumble on.

Successful turnarounds rely on another ingredient, too: plain hard work. That is something Mr Brenneman is used to. Growing up in rural Kansas, he once held three jobs at the same time during a school holiday, working from early in the morning until midnight. That work ethic has never deserted him. Colleagues say he often sends out e-mails written in the small hours of the morning. And although he has just stepped down as a full-time chief executive, Mr Brenneman will not be twiddling his thumbs: as well as his responsibilities at CCMP and Quiznos, he has his own small private-equity firm near his home in Houston and sits on the boards of Home Depot, a retailer, and ADP, a payroll-services company. With the global economy in the doldrums, this particular corporate doctor can expect to have plenty of patients queuing up in the waiting room.

Private equity and banks

Loan rangers

Aug 28th 2008
From The Economist print edition

Bill Butcher

Will private equity ride to banks' rescue?

IN MOST financial crises private equity is part of the problem. During a typical credit cycle it is among the first to use cheap financing to buy companies. Buy-out firms gradually become trigger-happy, overpaying and loading businesses with so much debt that some of them go bust. After the crash, the industry is in disgrace and skulks away to bind its wounds. Years later it returns, penitent, wiser—but hungry once again for cheap loans.

In this financial crisis, however, private equity thinks it is part of the solution. Buy-out firms have struck lots of dodgy deals, certainly, but they are still rich and ambitious. And amid the financial wreckage of the credit collapse, private-equity partners think they have spotted a chance to make a lot of money by helping Western banks to repair their tattered balance sheets.

This strategy partly reflects private equity's fund-raising before the credit crunch. Back then, pension and sovereign-wealth funds were not just sipping the buy-out Kool-Aid, they were swigging gallons of the stuff. As a result buy-out firms still have almost $450 billion of their cash to invest, according to Preqin, a research firm.

The boom also fed buy-out firms' aspirations. No longer are they content to act as Wall Street's vigilantes, picking off the weak and the stray. Most now have high fixed costs, in the form of hundreds of employees. Their ageing founders long to diversify their firms and propel them into the top ranks of the financial establishment.

So private equity has the ambition to rescue ailing banks and it has the money. But does that make it a good idea?

A brief history of timing

To understand how private equity reached this position, consider the long-term prospects of leveraged buy-outs (LBOs), its core business. In 2006-07 the industry binged, buying companies with an enterprise value of $1.4 trillion. After adjusting for inflation, that is the equivalent to one-third of all the LBOs ever. Denial and rose-tinted accounting mean that losses on these investments have yet to be fully recognised. But the shares of listed buy-out funds are trading far below their book value and some clients, anticipating losses, are reportedly considering off-loading their interests in LBO funds.

The academic evidence for the private-equity industry's historic returns is unclear. After fees and adjusting for leverage, the industry's performance is similar to that of publicly listed shares (given that both asset classes own companies' equity, this should not come as a surprise). But the poor deals at the top of the market could skew private equity's record downward.

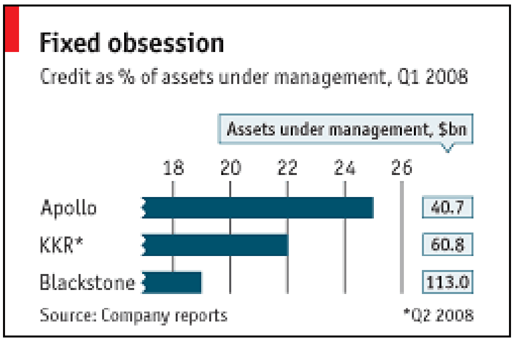
Optimists argue that credit markets will eventually recover. They also point out that the fall in stockmarkets means more bargains are available. Yet that is for later. In spite of all the equity it has to invest, the buy-out industry cannot now raise the debt it needs for large transactions. The banking crisis and sickly markets mean that there are no big loans to be had.

In any case, lower stockmarkets must be cold comfort to big clients like pension funds and sovereign-wealth funds, which saw private equity spend their cash at the top of the cycle. The shadow cast by those boomtime deals is one reason why, even if credit conditions improve, big clients may view LBOs with jaundiced eyes.

Private-equity firms could always hand back their clients' cash. That may yet happen, but they have every reason to resist. Many, including Kohlberg Kravis Roberts (KKR) and Apollo, plan to follow Blackstone and list their shares. That is hardly the time to be shrinking the assets they manage. In addition, a chunk of their fees is usually charged as a percentage of the capital they manage, regardless of whether it has been put to work. And most firms lock away cash for roughly a decade in funds that typically need a supermajority of investors to unwind them. Clients are complaining, but not that much.

This leaves a neat coincidence. On one side of the financial system are buy-out firms with ambition, long-term capital, discretion about how to invest it, and a dearth of opportunities to invest in industrial companies. On the other are banks, desperately short of capital and liquidity. It does not take a billionaire buy-out barbarian to put two and two together.

So buy-out firms are redirecting their buy-out funds towards financial assets and they are also raising new funds. Preqin estimates that a further $40 billion of new distressed-debt funds is waiting to be deployed. At the same time, big firms have been adding to their credit teams by buying fixed-income talent. In January Blackstone bagged GSO, a distressed-debt-management firm. Credit has already become a big part of the assets the leading firms manage: between a quarter and a fifth for Blackstone, KKR and Apollo (see chart).



Understandably, the first deals with banks have been close to home. Most buy-out firms have started by buying the distressed loans that banks issued to fund LBOs, many of which trade at 70-80% of face value. Only a few big deals have been made public: Citigroup's sale of $12 billion of debt to TPG, Blackstone and Apollo, for instance. But behind the scenes the activity has been frenzied.

Chris Taggert, of CreditSights, a research firm, estimates that the overhang of LBO loans that banks are waiting to sell on to investors has shrunk by $192 billion from the peak, to just $45 billion today. That chimes with the banks' own disclosures. An analysis by *The Economist* suggests that the amount of corporate junk debt on the balance sheets of ten of the largest banks in the loan markets had fallen by $205 billion, to $163 billion at the second quarter.

Hoovering up these loans makes sense in some ways. Buy-out firms are familiar with the debtor companies—they probably either control them or cast an eye over them during the boom. And the banks are so desperate to get these loans off their books that they provide financing, typically two-thirds of the purchase price, at low interest rates.

Take the high yields on the distressed loans and supercharge them with cheap debt and the internal rates of return look impressive. Blackstone has said it expects returns of 20-30% on the equity it has invested in LBO loans.

Yet there are risks, too. In buying LBO loans, the industry is doubling up its bet on a small pool of companies. Executives may believe in these businesses, but many of them are too indebted to cope with a downturn. Lately, the economy "has become a much higher concern" for loan traders, says Mr Taggert, which perhaps explains why loan prices have not recovered as the overhang of supply has shrunk. Most of the bank-financing packages stipulate that, if prices fall further, private-equity firms must post margin calls. And if the companies need to be recapitalised, it could lead to some toxic conflicts of interest—

should debt investors be favoured over old equity investors? Can money raised for new buy-outs be used as equity to bail out old ones?

Even if LBO loans make money, they are more like a junk-food snack than a substitute for private equity's staple diet of industrial companies. The supply of new loans is now limited, as many banks plan to keep the remaining exposures on their balance sheets. Most of the return from a typical LBO-loan deal comes from leverage. In the long run, clients are unlikely to pay high management fees for that.

From owing the bank to owning it

One alternative to buying banks' loans is to buy their holdings of the securities at the heart of the crisis—structured-credit products backed by mortgages. Blackstone is talking to "several institutions" about buying mortgages. Last month Merrill Lynch offloaded a pile of collateralised debt obligations at a knock-down price of $7 billion, or 22% of their face value, to Lone Star, a private-equity firm.

But Lone Star has a history of specialising in finance and such deals are unusual. When UBS auctioned a portfolio of securities backed by "Alt-A" mortgages in May, it received little interest from private-equity firms. This may be because these securities are highly technical. In addition, they are passive investments that do not call for the operational management where private equity thinks its skills lie.

For mainstream private-equity firms, the promising business may lie elsewhere: buying into banks themselves. Banks certainly need capital. Writedowns have reached a total of $500 billion, according to Bloomberg, but big lenders have raised only about $200 billion of tier-one capital, the Bank of England estimates. America's Federal Deposit Insurance Corporation, which monitors sick banks, now has 117 lenders on its watch list, compared with only 90 at the end of March.

This is not for the lily-livered. Banks are the original highly leveraged investments. Valuing them is tricky—just ask the sovereign-wealth funds that have lost money investing in them over the past year. Or TPG, which has lost money in Washington Mutual, an American lender, and ran into controversy when it got cold feet about bailing out Britain's Bradford & Bingley.

Yet some specialist private-equity firms have pulled it off. Lone Star turned round two Asian lenders, Korea Exchange Bank and Toyko Star Bank. On August 21st it said it was buying IKB, a German corporate lender that had made a disastrous foray into American subprime debt. And expertise can be bought. One executive thinks it is "relatively straightforward" to assemble a team with the operational and financial skills to run a bank. Big firms including Carlyle and TPG are now thought to be hiring the people they need.

The hurdle in America is regulation. The Bank Holding Company Act, which governs most big deposit-taking institutions (although not broker-dealers), stipulates that a voting stake in a bank of 25% or above constitutes control, whereas a holding of less than 5% does not. Between these two thresholds is a grey area that the Federal Reserve has interpreted conservatively, taking into account, for example, whether the owner can appoint directors or owns non-voting capital too. Control of a bank brings responsibilities—more supervisory oversight and the "source of strength" obligation that can require a holding company to inject capital into ailing bank subsidiaries. No private-equity firm wants to sign a blank cheque, and few would welcome regulators crawling over their books.

Before private equity takes the plunge, the rules may need to be tweaked. As early as next month, the Fed is expected to offer more guidance on the grey area of the ownership thresholds, probably relaxing its stance. Private-equity firms are also lobbying for the rules to loosen, so that they can form a consortium of buy-out firms without being deemed to have formed a "concert party" that has taken control. They also want permission from both the Fed and their clients to ring-fence the funds that invest in banks, so that their wider activities are safe from banking liabilities.

Will private-equity firms ride to the rescue of banks? Buy-out firms are unlikely saviours, but private equity's $450 billion war chest is big enough to fill Western banks' capital shortfall. There are few other sources of ready capital. Sovereign-wealth funds have been badly burnt; banks cannot easily raise equity in public markets; and the atrophy in many of the biggest lenders leaves them in a poor state to buy the weakest.

So regulators in America and elsewhere may feel obliged to ease their ownership restrictions. Until this year private equity had stuck to form, recklessly buying industrial firms at the top of the credit cycle. But

the industry's next guise could be less familiar—and more welcome. Private equity, saviour of Western banking. Who would have thought it?

American banks

When sorrows come

Aug 28th 2008 | NEW YORK
From The Economist print edition

Commercial banks prepare, reluctantly, to take centre stage

EVERY episode in the credit crunch has had its dramatic flourish. There were the defenestrations at Citigroup and Merrill Lynch late last year; then, in March, the Bear Stearns fiasco; the humbling of UBS; and now Fannie Mae and Freddie Mac, a tale of hubris that might impress Shakespeare himself. What next?

With the tragedy of the mortgage giants still unfolding, another dark drama is entering its second act, and it has rather a lot of players. It concerns America's commercial banks. "Pretty dismal" was the frank description of their recent performance offered on August 26th by Sheila Bair, head of the Federal Deposit Insurance Corporation (FDIC). That was just after announcing a rise in the number of banks on its danger list, from 90 to 117.

Nine banks have failed so far this year, felled by shoddy lending to homeowners and developers—six more than in the previous three years combined. The trajectory is steep: Institutional Risk Analytics, which monitors the health of banks, expects more than 100 lenders—most, but by no means all, tiddlers—to fold over the next year alone. Alarmingly, the ratio of loan-loss provisions to duff credit is at its lowest level in 15 years.

The FDIC will soon have to replenish its deposit-insurance fund, which collects premiums from banks and stood at around $53 billion before the downturn. One of this year's failures, IndyMac, has alone depleted the fund's coffers by one-sixth—and it was no giant. This has pushed the fund's holdings below a trigger point that requires the FDIC to craft a "restoration" plan within 90 days.

Ms Bair has indicated that banks with risky profiles—which already pay up to ten times more than the typical five cents per $100 insured—will be asked to "step up to the plate" with even higher premiums. This would ensure that safer banks are not unfairly burdened. But it will heap yet more financial pressure on strugglers. Bankers' groups have already started to protest loudly.

How much will be needed? Possibly far more than the FDIC is letting on, reckons Joseph Mason of Louisiana State University. Extrapolating from the savings and loan crisis of the early 1990s, and allowing for the growth in bank assets, he puts the possible cost at $143 billion.

That would force the FDIC to go cap-in-hand to the Treasury. The need to do so could become even more pressing if nervous savers began to move even insured deposits (those under $100,000) away from banks

they perceived to be at risk—which no longer looks fanciful given the squeeze on the fund. Ms Bair's admission, in an interview with the *Wall Street Journal*, that the FDIC might have to tap the public purse, albeit only for "short-term liquidity purposes", will have done little to calm nerves.

It is also sure to reinforce a growing sense that the financial-market crisis has a lot further to run. Risk-aversion, measured by spreads on corporate debt, fell sharply after the sale of Bear Stearns in March but has leapt back in recent weeks as the spectre of systemic meltdown resurfaced. Sentiment towards spicier assets is astonishingly grim: prices of junk bonds and home-equity loans imply a default rate consistent with unemployment of around 20%, points out Torsten Slok, an economist at Deutsche Bank.

Measure for measure

Banks continue to tighten credit, and their own belts—Citigroup has even restricted colour photocopying. What liquidity they have is being jealously hoarded, partly out of distrust of one another, but mostly in anticipation of refinancing requirements on bonds that they issued with abandon in the credit boom. The spread over expected central-bank rates that they charge one another for short-term cash has risen to three times the level that it was in January. Worse, derivatives markets point to a further increase. Another measure of trust, or lack of it, the index of the "counterparty" risk that derivatives dealers pose, is creeping back towards its March peak.

Nor have investors grown any more confident about their ability to price the banks' toxic mortgage-backed assets: Merrill Lynch's cut-price sale of collateralised-debt obligations in July has had few imitators. Lehman Brothers has tried unsuccessfully to sell a pile of iffy securities backed by commercial mortgages all summer.

The woes of Fannie Mae and Freddie Mac weigh on these efforts. Bankers feel obliged to advise clients against snapping up distressed securitised assets until the mortgage giants are put on a firmer footing, says one. And banks themselves are exposed: paper issued by the mortgage agencies accounts for roughly half of their total securities portfolios, estimates CreditSights, a research firm. American banks own much of the preferred stock (a hybrid of debt and equity) that the two firms issued. They were attracted by the preference shares' combination of a low risk weighting and decent yield, says Ira Jersey of Credit Suisse, but have seen their prices tumble on fears that they will be wiped out if the government moves to prop the agencies up. Although only a few regional lenders would be seriously hurt by this, it would add to the pain of many. JPMorgan Chase has just become the first bank to write down its holdings, saying it may lose $600m, or half the value it had put on them. That may start a trend.

Worse, banks have come to rely on issuing their own preference shares to raise capital, and will find that harder if holders of Fannie's and Freddie's paper suffer losses. Banks have raised a total of $265 billion of capital since last summer, says UBS. With much of that issuance underwater, investors are understandably wary of throwing good money after bad.

Contagion also spreads through the market for credit-default swaps. Banks have busily written such insurance contracts on Fannie's and Freddie's $20 billion of subordinated debt, which sits below senior debt in their capital structures. If the debt's holders suffer losses in a bail-out, triggering a "credit event", banks that had sold the swaps would face huge payouts. The amounts involved are "impossible to calculate but far from trivial", says one sombre analyst. As the bard wrote: "When sorrows come, they come not single spies, but in battalions."

Economist.com FINANCE & ECONOMICS

Buttonwood

A Nightmare on Wall Street

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Why the credit crunch has lasted so long

LIKE a Hollywood monster that is impervious to bullets, the credit crisis refuses to lie down and die. The authorities have bombarded it with interest-rate reductions, tax cuts, special liquidity schemes and bank bail-outs, but still the creature lumbers forward, threatening new victims with every step. Global stockmarkets are suffering double-digit losses this year, and credit markets are once again gummed up.

For investors who cut their teeth in the 1980s and 1990s, the persistence of the crisis must be a surprise. Prompt action by central banks, after Black Monday in 1987 (when America's stockmarket fell by almost 23%), or following the collapse of Long-Term Capital Management, a hedge fund, in 1998, suggested it was always worthwhile to "buy on the dips".

One reason why things are different this time is that there has been a double shock. On top of the decline in house prices and the associated drop in the prices of asset-backed securities, the markets have also had to face a surge in commodity prices. That has constrained central banks from easing monetary policy as much as they might have done, particularly in Britain and the euro zone. Even in America, rates might now perhaps be 1% (as they were in 2003) without the commodity boom.

In addition, the combination of the two shocks has created uncertainty about the direction of monetary and regulatory policy. Will the central banks be forced to "do a Turkey" and adjust their inflation targets upward (implicitly or explicitly) to reflect reality? Alternatively, will they crack down so hard on inflation that they force their economies into recession? And will the price of investment-bank rescues be a harsh new regulatory regime that restricts the scope for future credit (and economic) growth? In the face of all this uncertainty, investors can hardly be blamed for being cautious.

The way that the crisis has centred on the banking industry also explains its duration. Stephen King, an economist at HSBC, points out that the financial crises of the 1990s were also prolonged, from the savings and loan collapses in America through the Swedish banking rescues to the extremes of Japan's debt deflation. As Mr King says, "if banks are unable or unwilling to lend, monetary policy doesn't work so well."

Worse still, bank problems create a feedback loop with the rest of the economy. When banks get into difficulty, they restrict their lending. That in turn makes life more difficult for companies and consumers, causing them to cut their spending and making it harder for them to repay their debts. That forces further caution on the banks.

Recent economic data have highlighted how the gloom is spreading. Neither Germany nor Japan enjoyed a credit boom earlier this decade but both economies are suffering. Business confidence in Germany fell to its lowest level in three years, according to the latest Ifo survey, released on August 26th. "The credit crunch is morphing from an American-centred financial crisis into a global economic crisis," says David Bowers of Absolute Strategy Research, a consultancy.

Another reason why the crisis is lasting so long stems from the nature of the previous boom. Everyone was borrowing money, from homeowners buying houses they could not afford in the hope of capital gains, to investors buying complex debt products with high yields because of the extra "carry".

These investors were, directly or indirectly, beholden to the banks. Even when money was borrowed from "the market", the lenders may well have been hedge funds, conduits or structured-investment vehicles, all

of which had themselves borrowed money from banks in the first place. That former wellhead of finance has now run fairly dry.

In turn, that explains the absence of bargain hunters, particularly in the debt markets. Investment-grade debt might look attractive on a five-year view, if all you have to worry about is the risk of default. But most investors in that market have a three- or six-month view; they cannot afford for things to get worse before they get better, in case they are forced into a fire-sale of their assets.

So the markets (and the developed economies) are waiting for a catalyst for recovery. Lower commodity prices helped for a while, and may help further if they encourage central banks to cut rates. Evidence of a bottom in the American housing market may also do the trick. But the crisis seems certain to linger into 2009, and could even make it into the following year. Successful horror movies tend, after all, to have several sequels.

The European Central Bank

Closing the dustbin lid

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Banks will soon find it a bit harder to game the euro-zone's liquidity support

NO ONE could accuse the European Central Bank (ECB) of taking its lead from America. While policymakers there contemplate the salvation of Fannie Mae and Freddie Mac, the troubled government-sponsored mortgage firms, the ECB is set to tighten up its rules to ensure that what it offers to banks is strictly liquidity support, and nothing more. A change to the rules that govern its money-market operations could be agreed on by the bank at its next rate-setting meeting on September 3rd and 4th.

If so, it will mark a minor reversal in a global trend. As the credit crunch has intensified, central banks have relaxed the conditions for supplying ready cash to commercial banks. The Federal Reserve has made loans available for longer, and to more banks, to provide some security of funding. The Bank of England has temporarily widened the range of securities it accepts to include less pukka bonds, such as asset-backed securities (ABS).

Jean-Claude Trichet, the ECB's chief, has been able to boast that, unlike these central banks, the ECB has not had to change its lending policy. But there is growing concern that the ECB's liberality is being abused. A worry is that banks in countries where housing busts have made investors wary of mortgage-backed assets have created securities for the express purpose of gaining central-bank funding. This practice may be exposing central banks to too much credit risk, as well as stalling the recovery of the market for mortgage-backed assets.

There are signs of an increased dependence on ECB funding in some markets. The supply of central-bank cash in Ireland and Spain has more than doubled in the past year, both in size and as a share of the euro-area total (see chart). Ireland's huge share is bloated by lending to non-Irish banks located in Dublin. Fitch, a credit-rating agency, said in May that standards for newly minted mortgage-backed securities in Spain had slipped since the credit crunch started. Despite this, such securities are appraised at close to their face value. Because trading in ABS is so limited, there is no reliable market benchmark.

Another concern is that affiliates of foreign banks are using the ECB as a source of funds for lending outside the euro area. Macquarie, a Sydney-based investment bank (see article), was recently able to secure an ECB loan through a euro-area affiliate, putting up a security backed by Australian car loans.

The ECB has been discussing for several months how to tighten the rules to prevent such abuses, without disrupting its cash lifeline to banks. One idea is to increase the "haircuts" it subtracts from the market value of collateral, in order to protect against a decline in asset prices (the bigger the haircut, the smaller the amount that can be borrowed). Haircuts vary from less than 1% for the safest and most liquid government bonds to 18% for some long-dated asset-backed securities. Increasing the haircuts for some securities would offer extra protection against the risk that initial valuations of collateral are too generous.

When accepting collateral, the ECB could also restrict or ban the use of some securities that seem to have been created primarily to take advantage of central-bank funding. One tactic would be to rule that only a small fraction of any ABS or corporate-bond issue could be permissible. A severe haircut on newly created securities that have not been traded in private markets may be considered too. The ECB could insist that collateral is backed by income streams in euros, which would curb banks from using its funds to finance loans made outside the euro area.

Yves Mersch, head of Luxembourg's central bank and a member of the ECB's governing council, said at

the weekend that any adjustments to the bank's collateral policy would amount to fine-tuning. The bank is unlikely to want to disrupt the flow of liquidity by making big changes.

The ECB's main concern should be to shield its constituent central banks from the risk of loss if a bank defaults, and to ensure that banks are not shifting their credit risk onto the ECB on favourable terms. That would amount to a subsidy to those banks putting up poor-quality collateral.

Protecting central-bank capital is especially important in the euro area, which has no central fiscal authority. If a multinational bank collapsed and defaulted on its loans from the central bank, making good on any losses on the collateral would be a messy business.

Australian finance

Taking its toll

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Racy infrastructure investments come under scrutiny

COMPARED with the shoddy standards of its American and European peers, Babcock & Brown, a debt-fuelled Australian investment bank, has not done too badly, really. Its shares may have tumbled and it is having problems rolling over short-term debt and selling assets. But its infrastructure investments such as power plants, transmission cables, and ports, have continued to do well. An affiliated fund, Babcock & Brown Infrastructure Group, posted a A$51m ($44m) loss in the last fiscal year, but figures released on August 26th showed that cash profits were up strongly. Babcock itself is making money.

Challenger, a rival also big in infrastructure, has graver underlying problems, but nothing on the scale of global banks. On August 25th it unveiled a $A44m loss after write-downs. However, operating results were good and it did not seem to have any yawning black holes. Nevertheless, shortly after both it and Babcock reported this month, their chief executives were ousted. Their entire business models now seem headed for the scrap heap.

That model was pioneered by Macquarie, Australia's globe-trotting powerhouse, and involves putting an investment bank at the heart of a highly leveraged infrastructure-fund business, receiving big fees along the way. It too is now struggling, and has shuffled assets and shares from one fund to another. With the help of some institutional investors it has also taken one publicly listed fund private, which raises a troubling question: if the public markets value assets any differently from Macquarie, who is to say that Macquarie's numbers are right?

Sceptics smell blood, arguing that there was always a flaw in the investment case for infrastructure funds—that they held assets which were dull but stable and thus could support high leverage. On August 27th Macquarie's shares tumbled almost 10%, after a UBS analyst said that the global credit squeeze was hurting its business. Five days earlier Morgan Stanley issued a strikingly bearish report on Macquarie's main listed fund, Macquarie Investment Group (MIG). It listed numerous pressure points. Traffic on the fund's toll roads had, for example, been hit by high petrol prices, which meant people took fewer trips. MIG's long-standing practice of paying out more in distributions to shareholders than it received from the underlying investments worked when it was cheap to borrow money. It no longer is.

The investment banks are suffering from a staggering change in sentiment. In 2004 Babcock went public at A$5 a share, only to see its value peak at A$35 in mid-2007 before collapsing to A$2.70. The common factor appears to be liquidity. It used to be easy to buy and sell assets, and refinance debt. Now no leveraged investment firm appears to be any stronger than the weakest link in its debt structure.

As a result, an assortment of toll roads, ports and buildings are on the block, says one private-equity manager, though the sellers are still holding out for high prices. In a rare deal this month, Babcock admitted it would receive A$100m for a power plant in which it had invested A$220m. The buyer was the Tasmanian government, which was keen to avoid power shortages. Financial investors, who are not burdened by social concerns, are prepared to sit it out in the hope that prices will fall further.

It would be premature to declare the infrastructure business dead, however. MIG, for example, still has operating margins above 70%, and unlike Babcock, Macquarie is flush with cash in both its funds and core holding company, having raised A$22 billion from investors during its past fiscal year. Some deals are still being done; on August 4th Macquarie announced the purchase of a Channel Islands ferry service. Small stuff, all in all, but a sign that there is life in the industry—and that now is a good time to have money.

Poverty

The bottom 1.4 billion

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The world is poorer than we thought, the World Bank discovers

IN APRIL 2007 the World Bank announced that 986m people worldwide suffered from extreme poverty—the first time its count had dropped below 1 billion. On August 26th it had grim news to report. According to two of its leading researchers, Shaohua Chen and Martin Ravallion, the "developing world is poorer than we thought". The number of poor was almost 1.4 billion in 2005.

This does not mean the plight of the poor had worsened—only that the plight is now better understood. The bank has improved its estimates of the cost of living around the world, thanks to a vast effort to compare the price of hundreds of products, from packaged rice to folding umbrellas, in 146 countries. In many poor countries the cost of living was steeper than previously thought, which meant more people fell short of the poverty line.

Ms Chen and Mr Ravallion have counted the world's poor anew, using these freshly collected prices. They have also drawn a new poverty line. The bank used to count people who lived on less than "a dollar a day" (or $1.08 in 1993 prices, to be precise). This popular definition of poverty was first unveiled in the bank's 1990 *World Development Report* and was later adopted by the United Nations (UN) when it resolved to cut poverty in half by 2015.

The researchers now prefer a yardstick more typical of the 15 poorest countries that have credible poverty lines. By this definition, people are poor if they cannot match the standard of living of someone living on $1.25 a day in America in 2005. Such people would be recognised as poor even in Nepal, Tajikistan and hard-pressed African countries such as Uganda. But for those who still think a "dollar a day" has a better ring to it, the authors also calculate the number of people living on less than that at 2005 prices (see table).

The numerable poor

Number living below poverty line
$ per day, 2005 purchasing-power parity, m

	$1.00	$1.25
East Asia and Pacific	179.8	336.9
of which China	*106.1*	*207.7*
Latin America and Caribbean	27.6	45.1
South Asia	350.3	595.5
of which India	*266.5*	*455.8*
Sub-Saharan Africa	299.1	384.2
Other	22.2	37.9
Total	**879.0**	**1,399.6**

Source: Shaohua Chen and Martin Ravallion

The discovery of another 400m poor people will not satisfy some of the bank's critics, who think it still undercounts poverty. Its cost-of-living estimates are based on the prices faced by a "representative household", whose consumption mirrors national spending. But the poor are not representative. In particular, they buy in smaller quantities—a cupful of rice, not a 10-kilogram bag; a single cigarette, not a packet. As a result, the "poor pay more".

Such concerns prompted the Asian Development Bank (ADB) to carry out its own study of the prices faced by the poor in 16 of its member countries (not including China). Its results, released on August 27th, found that in nine of those countries the poor in fact pay less. Even though they buy in smaller quantities, they save money by buying cut-price goods from cheaper outlets: kerbside haircuts not salons; open-air stalls not supermarkets; toddy not wine.

This penny-pinching adds up. In Indonesia, for example, the poor's cost of living is 21% below the World Bank's estimate. The survey also shaved more than 10% off the cost of living in other populous countries, such as Bangladesh and India. The difference was narrower in smaller countries, such as Cambodia. This may be because in big countries, such as India, the rich are large in number, though a tiny part of the population. Perhaps their spending has an undue influence on the prices faced by the representative household.

The ADB's findings face an obvious philosophical objection. In theory a poverty count is supposed to calculate how many people fail to meet a certain standard of living. A person eating coarse rice, not fine-grained basmati, dressed in polyester not cotton, has a lower standard of living, even if he eats the same

amount of grain and owns the same number of shirts. And when a household buys fruit in a supermarket, its members are buying more than just an apple. They are also enjoying the comfort of air-conditioning, the convenience of a parking space, and the hygiene of airtight packaging. But until such comforts are within the poor's reach, the ADB is right to track the prices the poor actually pay. It hopes the next global price survey, due in 2011 and led by the World Bank, will do the same. Then, perhaps, the number of poor will be back to nine digits.

Economics focus

Capital ideas

Aug 28th 2008
From The Economist print edition

Can banks use a “capital insurance” scheme to dampen future crises?

REELING from billions of dollars of loan losses, banks have started to sell assets and rein in lending to keep their capital from eroding. This may be individually rational, but collectively it is imposing a vicious cycle of tightening credit, weakening growth, and further loan losses on the world economy. Small wonder that, once they get through this mess, many central bankers want to raise capital requirements—at least during good times. Had banks been forced to hold more capital, the boom might have been more constrained, and there would be less of a bust.

This sounds sensible. It may also be deeply flawed, according to a provocative new paper* presented at the Federal Reserve Bank of Kansas City’s annual economic conference in Jackson Hole, Wyoming. Compelling banks to hold more capital—typically, equity—goes against shareholders’ interests, because it results in a lower return on equity. This ultimately hurts economic growth because capital is diverted from projects that might have higher returns. In addition, worthy borrowers are denied loans. It may also be counterproductive, by encouraging banks to game the system.

So what is the solution? The novel proposal of the authors, Anil Kashyap and Raghuram Rajan, of the University of Chicago, and Jeremy Stein of Harvard University, is “capital insurance”: push banks to buy policies in normal times that deliver an infusion of fresh equity during crises. The proposal was the buzz among the assembled central bankers as they focused on how to deal with the next cycle.

Until the 1970s, memories of the Depression meant banks put a higher priority on capital than they did on growth. Then Walter Wriston, head of what later became Citigroup, revolutionised the industry by arguing that capital was often wasted. “The only reason we keep any capital is some of the old fogeys on my board insist that we do,” Mr Wriston told Paul Volcker, then president of the New York Fed, in the 1970s, Mr Volcker recalls.

Citi led the big banks into a new era of growth and diversification. But their emphasis on growth frequently led them to lend excessively, as they did to Latin America, resulting in massive write-downs and periodic financial crises.

Regulators responded in 1988 with the Basel Capital Accord which imposed uniform capital requirements on the world’s banks. But banks have always sought ways around the rules. Their use of off-balance-sheet vehicles to hold securitised mortgage paper in the last decade was largely driven by the fact that they required little or no capital. When lenders last year refused to refinance the short-term paper that funded the vehicles, banks had to take the assets onto their balance sheets, straining their capital ratios. “Since the business of banking is to take on and manage risk, any broad-based attempt to thwart risk-taking is likely to see it reappear in less transparent forms,” Mr Rajan told the conference.

The authors conclude that it is difficult to wean banks from leverage. Indeed, they question whether regulators should even try. Limited capital leads to good governance, they say. Supply bankers with too much equity and they will waste it on inefficient projects. Force them to rely on short-term debt, they say (rather overlooking evidence from the current crisis), and they will lend carefully lest wary investors yank their funds.

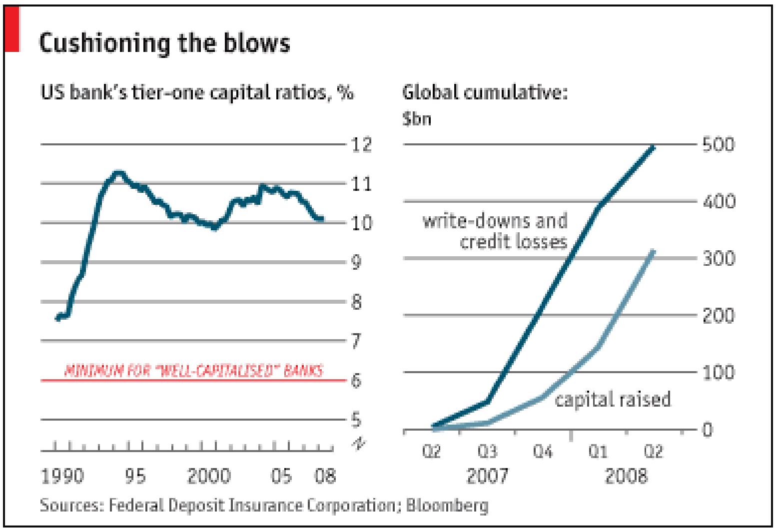
Moreover, higher capital requirements may not prevent banks from tightening the screws on the economy during downturns. In America banks are rapidly tightening lending conditions even though their “tier-one” capital—mostly shareholders’ equity—stood at 10.1% of risk-weighted assets as of June 30th, well above the 6% that regulators consider “well capitalised” (see left-hand chart, below). Bankers are not hoarding capital because they have hit their minimums, says Mario Draghi, governor of the Bank of Italy. Rather, they are worried that markets will punish banks where the capital buffers slip.

Mr Draghi, like many regulators, argues that capital ratios should be tightened—perhaps mimicking

Spain's well-regarded system, where capital requirements rise during lending booms and fall during busts. But Messrs Kashyap, Rajan and Stein argue that since crises are rare, that will saddle banks with lots of wasted capital most of the time.

Putting aside money for a rainy day

Instead, they propose that banks be made to choose between higher capital requirements and buying capital insurance. A pension or sovereign-wealth fund would earn a premium and in return deposit, say, $10 billion of treasuries in a lockbox. When a predefined point is met, the funds would be released to the bank.



Numerous questions dog the proposal, among them who would define the trigger point, where to set it, and what countries and types of firms (besides banks) should participate. Alan Blinder, of Princeton University, noted that crises hurt almost everyone. Unless an insurer can be found who benefits from a crisis, "the insurance premium is going to be extremely high, because you're making people pay in times when they don't want to pay."

Also, although the present system has hardly been perfect, it is not necessarily broken. True, it has encouraged risk-taking and short-term borrowing, and banks have allocated their resources neither efficiently nor wisely. Yet, for all the pain, no large bank has yet failed—thanks in large part to the capital they had been forced to hold. And banks have raised a remarkable amount of new capital, equivalent to almost two-thirds of cumulative write-offs so far (see right-hand chart), although this is getting harder.

Of course, the crisis is far from over. The conference fretted that with the financial shock now a year old, the real economy may still have not felt its full effect. It may yet be too early to overhaul today's capital arrangements. But change looks inevitable and even unconventional ideas are guaranteed a hearing.

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*"Rethinking Capital Regulation".
www.kc.frb.org/publicat/sympos/2008/KashyapRajanStein.08.08.08.pdf

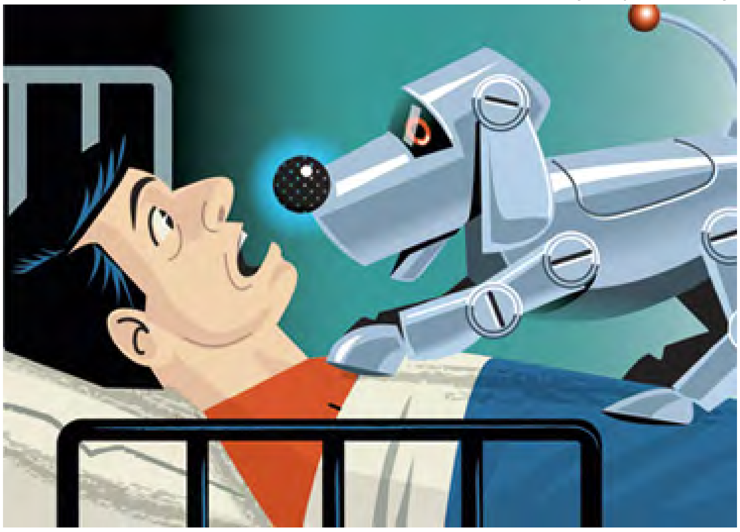
Economist.com SCIENCE & TECHNOLOGY

Olfactory diagnostics

Smelling bad

Aug 28th 2008
From The Economist print edition

Illustration by Stephen Jeffrey



Doctors may soon have a new diagnostic tool in their kit bags

SINCE time immemorial—or at least as far back as Hippocrates—novice physicians have been taught to smell patients' breath for signs of illness. Though unpleasant for the doctor, it is a useful trick. The sweet smell of rotten apples, for instance, indicates diabetes. Liver disease, by contrast, often causes the breath to smell fishy. But the human nose cannot detect all the chemical changes brought about by disease. Science, therefore, seeks to smell what human doctors cannot. The aim is to create a diagnostic nose as discriminating as those of perfume mixers or wine buyers. Such a nose would, however, be sensitive not to life's pleasures, but to its pains.

The idea of creating a diagnostic nose goes back to the 1970s. In that decade Linus Pauling, a Nobel-prize-winning chemist, performed the first serious scientific analysis of human breath. He used a technique called gas chromatography, which enables complex mixtures to be separated into their components, to detect some 250 volatile organic compounds in the air exhaled from lungs. Gas chromatography by itself, however, does not allow you to identify each component—it is merely a way of separating them. To make the identifications, you need to add a second step, called mass spectrometry. This, as its name suggests, works out the weight of the molecules in each component. Often, weight is enough by itself to identify a molecule. But if two molecules happen to have the same weight, they can be analysed by breaking them up into smaller, daughter molecules. These are almost certain to differ in weight.

Using gas chromatography and mass spectrometry, researchers have, over the years, identified more than 3,000 compounds that are regularly exhaled, excreted or exuded from the body. The search, now, is to understand how changes in the mixture of these compounds may indicate disease, and to find ways of recognising such changes routinely and robustly.

Exhaustive analysis

One of the first practitioners of the field of olfactory diagnosis, Carolyn Willis of Amersham Hospital in Britain, decided to contract the job out to dogs. They, she reckoned, have the necessary nasal apparatus to sniff out illness, and there was already some anecdotal evidence that they could, indeed, smell people with cancer. It worked. For the past four years her sniffer dogs have been diagnosing bladder cancer. She is now training them to detect prostate cancer and skin cancer as well.

But training dogs is probably not the best solution. It takes time and needs special skills, so mass-producing sniffer dogs would be hard. Moreover, a dog can give you only a yes-or-no answer. It cannot describe nuances, even if it detects them. Boguslaw Buszewski of Nicolaus Copernicus University in Torun, Poland, compares this approach to checking for fever by touching a patient's forehead. That tells you he is ill. However, it is only by measuring his temperature with a thermometer that you can discover how serious his condition is. In Dr Buszewski's view the breath-analysis equivalent of the thermometer is the mass spectrometer, and that is where effort should be concentrated.

Other researchers agree. Earlier this month Michelle Gallagher, of the Monell Chemical Senses Centre in Philadelphia, announced the results of a study that uses this approach. She confirmed that the early stages of basal-cell carcinoma, a type of skin cancer, can be detected by analysing the odour of a person's skin using gas chromatography and mass spectrometry. To do so, she sampled the air immediately above the tumours and compared its composition with that of air from the same sites in healthy individuals. She also checked the composition of the air in the room when nobody was present, as an extra control. She found that although air collected from both groups contained the same chemical substances, there was a difference in the amounts of some of them. This finding allowed her to produce what is known as a biomarker profile for the illness. That means it can be diagnosed reliably and—crucially—early on.

The combination of gas chromatography and mass spectrometry thus works. It can, nevertheless, take up to two days to run the tests. Dr Buszewski hopes to refine and speed up the process so that it can be carried out within an hour.

To do this, he has developed a device that can be tuned to pick up and concentrate the most relevant molecules. With patents still pending, he is cagey about the details, but the principle is to trap relevant molecules using columns made of metal or silica that are the width of a human hair. Each column is coated with special polymers tweaked so that they bind preferentially to particular compounds found in the breath. Pass a sample through a forest of these columns and the molecules of interest will be sucked out. They can then be flushed into the analytical machinery and a result quickly emerges.

Dr Buszewski is now tweaking his device so that it works with the biomarker profiles of a range of diseases. If he can do this successfully, olfactory diagnosis could become mainstream without a wagging tail in sight.

Magnetism and behaviour

Animal attraction

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Like compass needles, cows point north-south

ACCORDING to popular folklore, many animals are smarter than they appear. Dogs bark before earthquakes; chimpanzees know the right herbs to deal with intestinal worms; cattle predict rainfall by sitting on the ground. But cows, in particular, may have a hidden talent that far outweighs any meteorological skills. It appears they know which way is north.

Sabine Begall of the University of Duisburg-Essen in Germany and her colleagues became interested in animal magnetism when they were working on mole rats—blind animals that live underground and use magnetism to navigate. In a paper published in this week's *Proceedings of the National Academy of Sciences*, they looked at whether larger mammals also have the ability to perceive magnetic fields. They did so by studying images of thousands of cattle captured on Google Earth, a website that stitches together high-resolution satellite photographs to produce a simulacrum of the Earth's surface.

It was not merely a matter of looking for a few fuzzy blobs in fields and recording which way they were pointing. Grazing animals are known to orient themselves in a way that minimises wind chill and maximises the warmth of the sun when they are cold. Dr Begall and her colleagues therefore had to study a lot of cows grazing in lots of different places at different times of day, in order to average out these other factors and see whether there was a residual tendency for cattle to act like compass needles. They were also able to use data collected by colleagues in the Czech Republic on the grazing behaviour of roe and red deer.

The researchers concluded that cattle do generally align themselves in a north-south direction. Moreover, at high latitudes—where the geographical and magnetic poles are perceptibly separate from one another—it was to the magnetic pole that the animals pointed. Unfortunately, even the high resolution of Google Earth is not good enough to tell routinely which end of a cow is its head, and which its tail. Dr Begall was therefore unable to answer the vexed questions of whether cows prefer to look north or south, and whether that differs in the northern and southern hemispheres. With the Czech deer, however, the answer is a definitive "north".

These results, though curious, are not as unexpected as you might think. Several animals besides mole rats are known to be magnetosensitive. Some birds use magnetic fields to navigate. And north-south preferences like those Dr Begall thinks she has found in cattle have also been noted in flies, termites and honeybees. But the true extent of any magnetic "sixth sense" in animals remains unknown. Nor is it clear how this extra sense works. In birds, Dr Begall says, there is probably a receptor in the eyes. In mole rats there are hints of particles of magnetite (a naturally magnetic form of iron oxide) in the cornea. But how such crystals send signals to the nervous system remains a mystery.

As for people, there have been studies which suggest that magnetic fields influence biological processes such as rapid eye movement in sleep. Also, electroencephalograms seem to vary according to the direction in which people are facing when they are recorded. It is not quite GPS, but humans are clever enough to use a variety of phenomena to navigate when lost. Not least, of course, looking at which way the cows are pointing.

Archaeology

Amazon Garden City

Aug 28th 2008
From The Economist print edition

The world's favourite rainforest once had towns in it

RAINFORESTS are often thought of as virgin habitats: in other words, pristine ecosystems unaltered by the hand of man. A moment's thought shows that this cannot truly be so. People do live in rainforests, and where people live they must alter things. But the fact that those who live there these days tend to make their living by hunting wild animals and gathering wild plants may suggest that *Homo sapiens* could, in principle, be just another forest species—a natural part of the ecosystem that alters it only to the extent that any species inhabiting it would. To that extent, the forest is still "virgin".

In the world's largest rainforest, though, this argument no longer holds. The past few years have brought evidence suggesting that parts of the Amazon forest were settled and farmed before Europeans arrived in the area. Now Michael Heckenberger of the University of Florida, Gainesville, and his colleagues have provided some more. In a paper published in this week's *Science* they look at part of Brazilian Amazonia called the Upper Xingu. Here, they found, humans flourished between about 1,500 years ago and 400 years ago. Moreover, these people lived in urban societies that, even if they did not resemble traditional cities, matched them in population and social organisation.

Dr Heckenberger and his colleagues examined 28 settlements in Upper Xingu. At first blush, each settlement could have passed for an independent town or village, but closer examination suggested they were actually organised into two groups that the archaeologists refer to somewhat grandly as "galactic clusters".

Each cluster had a central settlement, two large daughters 3-5km (2-3 miles) away to the north-west and south-east, and two smaller daughters 8-10km away to the north-east and south-west. All of these settlements, mother and daughters, were fortified with palisade walls and ditches, and contained streets aligned north-west—south-east, north-south and north-east—south-west. These streets linked up with cross-country roads that ran through the farmed area around a settlement to other centres of population within the cluster, including smaller settlements still, which were unfortified.

The most characteristic feature of each settlement, regardless of its size, was a plaza—an open space that acted as a cemetery and may have been a marketplace. It was also, the archaeologists suspect, a place of political assembly, just as the agora in an ancient Greek city was both marketplace and legislature.

Dr Heckenberger and his colleagues interpret all this as what might, in modern parlance, be thought of as a city surrounded by a set of isolated suburbs, a bit like the satellite garden cities that were popular in European town planning during the first half of the 20th century. Each cluster, they reckon, would have had a population of more than 2,500 people. Until a few centuries ago in a place like Europe, that would have constituted a sizeable town.

Indeed, a more general survey of the Upper Xingu suggests these cluster settlements were the norm. The team reckon there were 15 such clusters around, occupying an area of 20,000 square kilometres (8,000 square miles) and with a combined population of over 50,000. A flourishing settled area, then, and certainly no virgin forest.

Moreover, Dr Heckenberger sees similarities between his team's discoveries in Brazil and others from eastern North America and parts of Europe. There, too, early urban settlements may have been larger than appears at first sight.

All this argues that, for reasons of the history of their own subject, archaeologists are too fixated on the idea of big urban centres such as those that developed along the great rivers of Egypt, Mesopotamia and northern India. Such places are spectacular but not, perhaps, typical. A less showy system is better suited to settling a forest. The suburbs, it seems, are not a new invention after all.

Evolution

Beetle drive

Aug 28th 2008
From The Economist print edition

Dung beetles provide an object lesson in the speed of natural selection

ONE of the lies regularly promulgated by creationist ideologues is that you cannot see evolution in action right now. For microorganisms this is obviously untrue. The evolution of new viral diseases, such as AIDS, is one example. The evolution of antibiotic-resistant bacteria is another. But bacteria and viruses breed fast, so natural selection has time, within the span of a human life, to make a difference. For species with longer generations, examples are less numerous. But they do exist.

A new one has just been published, appropriately, in *Evolution*. It concerns dung beetles. Harald Parzer and Armin Moczek, of Indiana University, have been studying a species called *Onthophagus taurus*. Or, rather, it was a species 50 years ago, but it is now heading rapidly towards becoming at least four of them.

Onthophagus taurus lives naturally in southern Europe and the Middle East, but it has booted about a bit and is now found in many other places too. Mr Parzer and Dr Moczek looked at beetles from the east and west of Australia (where it was deliberately introduced to deal with the dung of non-native livestock) and North Carolina, together with an aboriginal population from Italy. Their interest was the trade-off that the males of various populations make between what they delicately describe as the beetles' primary and secondary sexual characteristics—in other words, their penises and their horns. The researchers' hypothesis was that the bigger the horns, the smaller the penis, and vice versa.

Male *Onthophagus* beetles use their horns to fight over females. Lose a fight and you do not get to mate. On the other hand, if you do get to mate, having big sexual organs is likely to increase the chance that it will be your sperm, rather than another male's, that fertilise the female's eggs. Beetles, like butterflies and moths, have a four-stage life cycle of egg, larva, pupa and adult. Mr Parzer and Dr Moczek hypothesised that given the limited resources available to make an adult beetle (in other words, the flesh of the larva that made the pupa), those parts of the adult focused on reproducing will take a constant chunk. Exactly how that chunk is allocated will depend on the local conditions the adult has to face. The more fighting it is likely to have to do, the more its horns will require, and the less will be left over for its penis.

The horns of a dilemma

As they predicted, the two researchers found that the bigger a beetle's horns, the smaller its penis. More importantly, though, the ratio was different in each of the four populations, but similar within each population. That suggests it is being set by local natural selection in each place. Moreover, Mr Parzer and Dr Moczek also looked at ten other species of *Onthophagus* to see whether the trade-off applied to them too. It did. The ratio of horn to penis size was different in each species, but consistent within a species.

Given the need for male and female organs to fit together, the researchers suggest that selection of horn size might be the main method of speciation in *Onthophagus.* Horn size determines penis size. Penis size then dictates vagina size. That stops crossbreeding between groups and provides the reproductive isolation that groups need to evolve into species.

As evidence, they point out that the genus *Onthophagus* has 2,400 species—more than any other in the animal kingdom. And their work suggests it is just about to get three more, in the shape of the east and west Australian, and North Carolinian populations, if, indeed, these groups are not species already. Since it is known when these populations were introduced, and none is more than half a century old, evolution seems to have worked its wonders well within a human lifetime. Darwin, no doubt, would have been delighted.

Iraq on film

Waiting for John Wayne

Aug 28th 2008 | LOS ANGELES
From The Economist print edition

Jonathan Olley

American audiences have been staying at home, not tempted by films about an unpopular war. Perhaps the emergence of a new hero may do the trick

WITH one exception, films about the Iraq war have done badly in American cinemas. The exception was Michael Moore's "Fahrenheit 9/11", a fiercely anti-war film made the year after the invasion. Though Disney refused to distribute it, the movie still made a fortune. But the films that came after it have mostly bombed at the box office, a fact that has led film financiers to regard the war with a superstition as potent as that which has actors referring to "Macbeth" as "the Scottish play".

Why is this so? Persuading audiences to flock to a film about an unpopular war is obviously difficult. Comparisons with Vietnam don't really work. Television coverage of the Vietnam war was so intensive that Hollywood did not bother to make many films about it while it was going on. (John Wayne's "The Green Berets" was released in 1968 as a corrective, it was hoped, to the TV coverage that was turning the country against the war.) But, with Iraq, that situation is reversed. The *New York Times* has reported that the three major American television networks logged only about 180 minutes of weekday evening reporting on the war in the first half of this year (compared to 1,157 minutes for all of 2007), and that CBS News no longer has a full-time correspondent in Iraq.

Film-makers are trying to fill the gap but their efforts, though worthy, are often depressing—and certainly not designed to pull in 14-year-olds at the mall. The best of the recent lot are Kimberly Peirce's "Stop-Loss" (2008), in which a decorated soldier is ordered back to Iraq against his will, and "Redacted" (2007), Brian De Palma's re-enactment of an atrocity. The latter film, made with Canadian money, uses *faux* video clips to tell the awful tale of the rape and murder of a young Iraqi girl by American soldiers. "Stop-Loss" and "In the Valley of Elah" (2007), about a former military cop trying to find out who murdered his son after he returned from Iraq, were both made by studio speciality divisions created for modestly budgeted films, both of which have since been folded into their parent companies, Paramount Pictures and Warner Bros.

Several reasons were cited for the poor showing of the one star-studded vehicle among recent anti-war films, Robert Redford's "Lions for Lambs" (2007). Tom Cruise plays a Republican senator trying to sell a new strategy for victory to a reporter played by Meryl Streep, and one explanation given for the film's failure is that Mr Cruise's star may be waning (though presumably this does not apply to Ms Streep, who is one of the summer's box-office champions). Another is that audiences have lost interest in Iraq. But this is a journalistic commonplace not borne out by opinion polls. The real reason may be that the film

just has too much talk.

Frank Rich, a columnist with the *New York Times*, predicted that apathy would doom “Standard Operating Procedure” (2008), Errol Morris’s haunting documentary on torture at Abu Ghraib—and the film did indeed fail. “Unable to even look at the fiasco [of the war] anymore,” Mr Rich wrote, “the nation is now just waiting for someone to administer the last rites.”

But there is still a reservoir of public anger which was successfully tapped by Charles Ferguson in his 2007 documentary “No End in Sight”, a film that describes the failure of the occupation through the eyes of military and foreign-service professionals. Perhaps similar anger will make a success of Paul Greengrass’s “Green Zone”, a film coming out next year starring Matt Damon and inspired by “Imperial Life in the Emerald City”, a prize-winning book by Rajiv Chandrasekaran, a former Baghdad bureau chief for the *Washington Post*.

Depression about the war is reflected in the stylised way that Hollywood paints the home front. “In the Valley of Elah” shows a bleak world of honky-tonks, fast-food outlets and faceless motels surrounding an army base. In James Strouse’s “Grace is Gone” (2007), a widower played by John Cusack, unable to tell his two little girls that their mother has died fighting in Iraq, takes them along a road lined with identical franchises and discount megastores to a sad little dream-world of an amusement park.

Will Kathryn Bigelow’s “The Hurt Locker”, premiering at the Venice Film Festival, succeed in disarming audience resistance? About a bomb squad defusing “improvised explosive devices” planted by insurgents in Baghdad, it is a thrilling combat film from its first image of a bomb-handling robot racing through the rubble. Then a new squad leader walks in, and the film has a hero. Staff Sergeant William James, played by Jeremy Renner (pictured above), is a wild man addicted to the adrenalin rush of doing the most dangerous job in the world. He is a character who can embody the central myth of American cinema because his job is saving lives, not taking them.

“James is the man who walks down that street in the direction that everyone else is running from,” says Ms Bigelow. “He has an iconic aura. But those traits exert a heavy price.” By making a film about an unpopular war that still gives the audience someone to root for, she may have struck gold. Perhaps the return of John Wayne is what people have been waiting for.

Economist.com BOOKS & ARTS

A critical American view

Lost sheep

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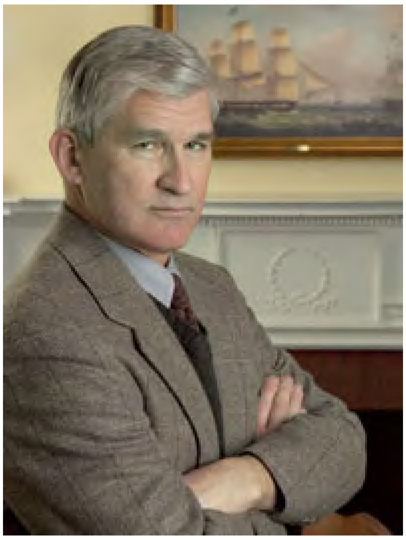
From The Economist print edition

REPENT ye! cries Andrew Bacevich. With the fervour of the prophet Jeremiah, but with more wit, he denounces the profligacy of modern America. If there is one word that defines the identity of what the republic has become, he says, echoing a later prophet, Saul Bellow, it is “more”.

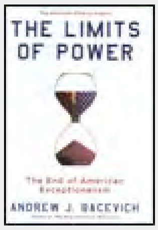
Mr Bacevich’s strongly felt and elegantly written book is indeed a jeremiad. He claims that the constitution has been perverted by the expansion of the presidency and by national security, at the expense of Congress. Concluding that America’s military power “turns out to be quite limited”, he argues that the country “doesn’t need a bigger army. It needs a smaller—that is, more modest—foreign policy, one that assigns soldiers on missions that are consistent with their capabilities.”

Kalman Zabarsky



Don’t ask for more, says Mr Bacevich

The Limits of Power: The End of American Exceptionalism
By Andrew J. Bacevich



Metropolitan Books; 206 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

This might sound as though his was a shrill voice of the left. It is not. Mr Bacevich is a former colonel in the American army who is now a professor of international relations and history at Boston University. But he does share much of the left’s analysis of what has gone wrong. This includes both its dislike of what he calls (quoting the theologian Reinhold Niebuhr) the “most grievous temptations to self-adulation” brought about by American exceptionalism, and its perception that America has long been accumulating an empire. But he comes to these conclusions from the position of a genuine conservative.

He expresses his judgments, some grumpy, some anguished, in sharp, epigrammatic language. “A grand bazaar”, he writes, “provides an inadequate basis upon which to erect a vast empire.” Americans have recast the Jeffersonian trinity—life, liberty and the pursuit of happiness—to read: “Whoever dies with the most toys wins”; “Shop till you drop”; and “If it feels good, do it.”

“Citizens”, he remarks with justice, “yearn for a restoration of a mythical Old Republic. Yet one might as well hope for the revival of the family farm or for physicians to resume making house calls.” Beginning with the election of John Kennedy, he writes, “the occupant of the White House has become a combination of demigod, father figure, and, inevitably, the betrayer of inflated hopes.”

People complain of what Arthur Schlesinger called “the imperial presidency”. But this, snorts Mr Bacevich, is “mere posturing”. For members of the political class, serving, gaining access to, reporting on, second-guessing or gossiping about the emperor-president (or about those aspiring to succeed him) has become an abiding preoccupation.

He is an acidulous critic of the incumbent administration and its military servants. Yet he does not comfort himself with the idea that the election of a new president would easily change things for the better. “No doubt the race for the presidency matters. It just doesn’t matter as much as the media’s obsessive coverage suggests.”

This is an astringent book and at times, like any Old Testament prophet, its author is too harsh in his demands on mere mortal politicians and generals. It is also painfully clear-sighted and refreshingly uncontaminated by the conventional wisdom of Washington, DC. Listen to Jeremiah again: “My people, saith this prophet, hath been lost sheep: their shepherds have caused them to go astray.”

The Limits of Power: The End of American Exceptionalism.
By Andrew J. Bacevich.
Metropolitan Books; 206 pages; $24

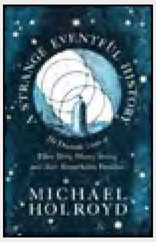
British theatre

A soap opera from earlier times

Aug 28th 2008
From The Economist print edition

SIR MICHAEL HOLROYD, the doyen of British biographers, is like a great landscape painter who works on a large, unwieldy canvas. This book began as a modest biography of Dame Ellen Terry, an enchanting Victorian actress whom the *Times* called "the uncrowned Queen of England". Then the author's plot got out of hand and embraced the most eminent of all actor-managers, Sir Henry Irving, together with four children, two from Irving's failed marriage and two from Terry's infatuation with Edward Godwin, an architect who dabbled in the theatre. The author confesses that his choice of such a broad canvas was "foolhardy" but his rambling tale of theatre people is captivating.

A Strange Eventful History: The Dramatic Lives of Ellen Terry, Henry Irving and their Remarkable Families
By Michael Holroyd



Chatto and Windus; 620 pages; £25. To be published in America by Farrar, Straus and Giroux in March 2009

Buy it at
Amazon.co.uk

In Ellen Terry's lifetime, from 1847 to 1928, leading actors were simultaneously celebrities and social outcasts, but she simply ignored Victorian prejudices. George Bernard Shaw, a great admirer, wrote: "She walked through them as if they were not there, as indeed for her they were not."

Irving, with whom she acted the great Shakespearean roles at the Lyceum Theatre in London, was more calculating and eventually became the first British actor to be knighted—an honour that was delayed because of the scandal created by the romance between the two. Both families thought they had not been lovers but Sir Michael leaves us in little doubt. It would have been rash to confess at the time, but when Irving was dead, Terry said that of course they had been.

Before and after her passion for Godwin, she married three times. Her first husband was an artist, G.F. Watts; the last was an American actor half her age. Irving was no Victorian role model either, having left his wife as they drove home from his greatest triumph, a melodrama called "The Bells". "Are you going to make a fool of yourself like this all your life?" she asked. He stopped the brougham at Hyde Park Corner, alighted and never saw her again.

The lives of Irving's children, Henry and Laurence, are a tragic strand in the story. Despite the opposition of their mother, both of them were enthralled by the theatre and became fairly successful actor-managers. But Laurence drowned when he was 43 (a ship bringing him home sank after a collision in the St Lawrence river) and Henry was only six years older when he died of anaemia in 1919.

Ellen Terry's children provide the comedy, though the author reminds us of Thomas Hardy's dictum: "All comedy is tragedy, if you only look deep enough into it." Her daughter Edy joined her in the theatre, principally as a costume designer, but her preoccupations were feminism and the quarrelsome lesbian circle with whom she grew old in the Terry household. The only character in the second generation to rival the actress's flamboyance was her son, who became celebrated himself as Edward Gordon Craig, a theatrical visionary who achieved little but talked well enough to be awarded the Companion of Honour by the queen in 1958, when he was 86.

Craig had a vision that the future of the theatre lay in lights, sounds, shadows and screens at the expense of "the dry words of dramatic poets, the fancy games of foolish actors and the vain calculations of producers". He wrote a controversial manifesto "On the Art of the Theatre". But what is truly memorable about him in Sir Michael's account is his performance as a serial seducer. He married twice and had six children by his wives, but there were another six from six lovers, three of whom conveniently doubled as his secretary.

Konstantin Stanislavski, a legendary Russian director, thought Craig was a genius, and so did Craig himself—a conviction that receives little encouragement from the author. So incorrigible was Craig that he was forgiven for his dalliance with fascism (in 1941 he was released from a prison camp in Besançon

in France by an admirer from Hitler's headquarters staff). His death in 1966 ends Sir Michael's delightful narrative—he has given up footnotes—which reads like a series of compelling scripts for an extravagant soap opera, perhaps titled "WestEnders".

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Opera

Kings and queens and shepherds

Aug 28th 2008 | EDINBURGH
From The Economist print edition

A difficult opera is given an exciting new production at the Edinburgh festival

IN A new production brought to the Scottish capital by Valery Gergiev and the Mariinsky Opera Company of St Petersburg, Karol Szymanowski's philosophical opera, "Krol Roger", proved one of the most exciting presentations at this year's Edinburgh festival. Mariusz Trelinski, a young Polish director, has turned away from Szymanowski's placing of the drama in King Roger II's 12th-century Sicily, and focused instead on something more modern. He keeps to the text in setting the first act in a church, but the grey metallic walls, the queen's black sequins and stilettos and the royal couple's security detail dressed in shades provide a disquieting contemporary atmosphere. When the shepherd, Szymanowski's symbol of rebellious individualism, makes his entrance, it is between two guards who drag him in by the armpits and flop him onto the floor.

With little plot, but a ferment of ideas, "Krol Roger" has traditionally been seen as a remake of Euripides's "The Bacchae", which pits the rationalism of classical Greece against the exoticism of the invaders from the east. But Mr Trelinski gives it overtones that are unmistakably political and erotic. In the second act the curtain rises to reveal an oligarch's penthouse. Seated on its cushy sofas, the embattled king is fighting demons without and within. The established order is under threat; the shepherd is luring away the king's followers with promises of freedom and fun. Queen Roxana, in flowing pea-green silk with a plunging neckline, looks forward to a new spring in the shepherd's company. By the act's end, the shepherd may still be in shackles, but it is Roger who is on trial. In the short final act Roxana is destroyed by the choices she makes, while Roger, having embraced some of the shepherd's passionate spirit, emerges as a man transformed.

Mr Gergiev, fresh from conducting a Russian victory concert in the ruins of the capital of South Ossetia, Tskhinvali, kept a firm hand on the Mariinsky's orchestra and chorus of 130 to bring out the complexities of Szymanowski's score, with its long passages for oboe, bassoon, horn and clarinet. But it was the evolution of the two main voices that really made the evening.

The shepherd, sung by the young Ukrainian tenor, Pavlo Tolstoy, who so impressed the demanding St Petersburg audience when the opera opened there last month, proved a light-hearted confident tease when he sang on his own and a thrilling foil in the duets with Elzbieta Szmytka's Roxana. Meanwhile, Andrzej Dobber, the Polish baritone singing Roger, brought subtlety and power to the role of a ruler who journeys from brittle loneliness to strength and nobility.

Marriage

It gets better, or so they say

Aug 28th 2008
From The Economist print edition

September Songs: The Good News about Marriage in the Later Years
By Maggie Scarf

Riverhead Books; 256 pages; $24.95

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"I'M SO glad that I'm not young any more," sang 70-year-old Maurice Chevalier in the film "Gigi". Quite right, says Maggie Scarf, an American journalist who has written a succession of books on family and marriage. In this one, she turns her attention to couples in their 50s and 60s, and finds older marriage is full of unexpected pleasures.

Is it just a sense of the shortening future that makes married couples grow more comfortable together with age? Perhaps. But, as she points out, the future for older people is not nowadays so short: in 1900 life expectancy at the age of 65 in the United States was 11.5 years for men and 12.2 for women; by 2003 that had risen to 16.8 and 19.8 respectively, and is still growing.

This is a journalistic book—a collage of interviews with half a dozen couples and descriptions of research reports—and the material is sometimes stretched. But the clearest message, both from the research and from the couples, is upbeat. Those later years are, of course, a time of adjustments. The nest empties. Retirement approaches. The body may start to hint that it is not immortal. Lust languishes, in spite of Viagra. As in late adolescence, argues Ms Scarf, people once again have to forge an individual identity. Without a growing family or a career to provide self-definition, older people must answer anew the teenage question, "Who am I?"

This time around, however, the answers are more manageable. The popular image of these late years may be of crusty and decrepit ancients. The reality is that, as people age, their conflicts grow less acute and their ability to draw pleasure from the more agreeable aspects of life increases. In the words of one group of researchers whose work Ms Scarf examined: "Older couples, compared to middle-aged couples, expressed lower levels of anger, disgust, belligerence and whining and higher levels of one important emotion, namely affection." The parts of the brain associated with anger and aggression gradually shrink as people cross the threshold to old age. Emotional stability steadily improves.

Should unhappily married people split up? Ms Scarf addresses this question in a chapter called "Does Divorce Make People Happy?" The short answer seems to be, rarely. She quotes a study of people in unhappy marriages which followed up the couples five years later. Its conclusion: unhappily married adults who divorced or separated were no happier, on average, than unhappily married adults who stayed married to the same partner. Only one in five of them was happily remarried. More surprisingly, a majority of those who remained married pronounced themselves happy at the end of the five-year period.

Among Ms Scarf's interviewees are several couples who went through a rocky patch but stayed together. What word, she asked one couple, would describe the later years of their lives together. "The new beginning", said one partner. "Peace", said the other. So be it, if you can make it to that point. Perhaps Chevalier was right.

September Songs: The Good News about Marriage in the Later Years.
By Maggie Scarf.
Riverhead Books; 256 pages; $24.95

Economist.com BOOKS & ARTS

London's National Gallery

Getting away from cultural spinach

Aug 28th 2008
From The Economist print edition

Nicholas Penny has original plans for drawing crowds to the National Gallery in London

“WE SO much need to sort out our exhibition programme,” says Nicholas Penny, who has been director of London’s National Gallery since February. Why should that be? The gallery’s exhibitions devoted to Caravaggio, Raphael, Titian and Velázquez were thrilling and hugely popular. But Mr Penny is disinclined to go on concentrating on big-name monographic shows. To do so would mean turning the permanent collection into a vast loan bank. The pictures would be constantly travelling to other museums, so that these museums would return the favour and lend theirs. This would defeat the gallery’s core purpose: the preservation and presentation of its magnificent permanent collection.

Mr Penny intends to continue giving the public the big exhibitions it has come to expect but in such a way that more people are encouraged to get to know the permanent holdings better. The question is how this can be done. Mr Penny may offer a clue on September 16th when he announces his first year-long exhibition programme. His choices are bound to be informed by his gifts as art historian and curator but also by a rather less obvious attribute. He is a man of imagination.

At first meeting 58-year-old Mr Penny is a bit daunting. Tall, thin and diffident around the edges, he speaks at twice normal speed, often inserting parenthetical commentary on his thoughts as he gallops ahead. Will he be impatient with those who know less about art than he does (which is nearly everyone)? In fact he turns out to be quite funny, attracted to stirring things up and allergic to orthodox thinking. As he says, the only regrettable aspect of being director is that now people too often tell him what they think he wants to hear. Usually this means suggesting that all is just dandy the way it is. This is not only unhelpful but, he thinks, untrue.

He joined the National Gallery in 1990, becoming Clore curator of Renaissance painting. He first applied for the director’s job in 2002 when Neil MacGregor stepped down. Charles Saumarez Smith was selected and Mr Penny left for the National Gallery of Art in Washington, DC. Five years later Mr Saumarez Smith decamped to the Royal Academy of Arts and Mr Penny was second-time lucky.

But after five years in Washington, the National Gallery did not seem quite the same. Mr Penny jokes about the scarcity of colour photocopiers. More serious is the gallery’s decor. Although the opulent redecoration of its principal rooms, begun in the early 1990s, seemed fine to him at the time, much of it does not now.

The richly coloured damask-covered walls do evoke the palaces for which many of the pictures were intended, but those palace rooms would have been furnished with mirrors and gilded console tables and the pictures hung in tiers. In the gallery’s bare rooms, the paintings hang in a single line. Instead of the walls whispering of emerald green, claret and sky blue, they now shout luxury. Redecoration will come, as will the restoration of natural light. But slowly.

Decisions about future exhibitions, and how to draw people in to see the permanent collection, are more pressing. He is not short of ideas. Among the more unexpected of them is the following proposal for a television series.

Two teams of curators would compete; say one from New York’s Metropolitan Museum of Art and the other from the National Gallery. A picture would be shown to them. The Met might lead off with: “This is Italian.” The National Gallery might counter with: “Oh, I don’t know…It could be southern Bavarian.” Each contestant, wanting to prove his or her superior expertise, would at the same time not want to make a mistake. Back and forth they would see-saw before finally agreeing that it’s one or the other. The quiz master would then pounce, asking for a date and who it’s by. The experts would be spurred on by the desire to be first with an attribution—but held back by the fear of looking foolish. The resulting tension would be part of the viewer’s enjoyment of a programme that might, perhaps, begin to rival the

ratings of the “Antiques Roadshow”.

“They might be showing off a bit,” Mr Penny says of the participants. “But what they would be saying would be completely different from what they’d write in a blurb for the painting, were it in a show. And the public would be riveted.”

Art presented as visual and intellectual sport, rather than as high fashion or so much cultural spinach, might suddenly come alive to the many for whom it now is not. Tens of thousands of viewers might then troop off to Trafalgar Square to see these works in the flesh, so to speak. Connoisseurs of the collection would find such crowds irritating, of course. But Mr Penny, no snob, inverted or otherwise, offers practical advice. Study daily visitor patterns. Times for quiet contemplation can easily be found.

Jack Weil

Aug 28th 2008
From The Economist print edition

Reuters

Jack A. Weil, patriarch of western clothing, died on August 13th, aged 107

IN THE annals of fashion the snap-fastener, or press-stud, holds a humble place. Few care that it was invented in Germany, as the *Federknopf-Verschluss*, in the 1880s. Not many appreciate that some varieties have discs and grooves, while others boast sockets with studs. And almost no one considers that they give a man style. But Jack Weil did.

Mr Weil reckoned that a cowboy on a horse, if wearing a shirt with buttons, was liable to get snagged on sagebrush or cactus or, worse than that, get a steerhorn straight through his fancy buttonhole. He was pretty certain, too, that a cowboy losing a button would feel disinclined to sew it on again. The answer to all those difficulties was to make shirts with snap-fasteners. And for 62 years, in a red-brick warehouse in the LoDo district of Denver, Mr Weil did exactly that.

He also added a few more customisings. Pockets with sawtooth flaps, to keep tobacco in; a yoke fit, to broaden out the shoulders; body-hugging seams, to show the fine muscles of a cattleman; and deep cuffs. The hats, belts, buckles and bolo ties, which he also commercialised, were optional. But the snap-fasteners were *de rigueur*: topped with pearl and backed with tin, square or circular or diamond-shaped, strong enough to pass without cracking through the wringer of a 1940s washing-machine, and flash enough to turn heads on the streets of Denver on a Saturday night. “A cinch”, as Mr Weil proudly said.

Until he created his shirts, there was no distinctively western look in American couture. There were cowboys; but they wore dusty working clothes, accessorised with sweaty bandannas and clanking spurs, that no one much cared to copy. Indeed, Mr Weil early on in his career made work-gear for cowboys, and learnt an important fact: they had no money. If he wanted to make any money himself, he would have to appeal not to the catwalk instincts of cattlemen, which were hard to spot, but to wannabe easterner cowboys who lived in, say, New York. Fortunately, there were plenty of them.

His shirts, sold after 1946 through his company, Rockmount Ranch Wear, became extremely famous. The Premium Blue Flannel Plaid was worn by Ronald Reagan, and the Pink Gabardine by Bob Dylan. Eric Clapton liked the diamond-snap number; Robert Redford in “The Horse Whisperer” wore a rayon plaid. Mr Weil’s company clad Elvis Presley, John Travolta and almost everyone, gay or straight, in “Brokeback Mountain”. It also made the shirts, in red, white and blue, for the Colorado House delegation at this year’s Democratic convention. Mr Weil very narrowly missed seeing them, but that would not have troubled him. He thought that “any young man worth his salt” ought to be a Democrat; but that once he had a bit of money, the only way to keep hold of it was to turn Republican.

In his long, long life, Mr Weil accumulated plenty of simple business sense. He knew J.C. Penney, and thought him smart. Levi-Strauss was a nice fellow, but got too big for his britches; Sam Walton, founder of Wal-Mart, was a “hillbilly son of a bitch”. Walton constantly harassed him to supply Wal-Mart with shirts, but Mr Weil never wanted any customer to take more than 5% of his business. He felt he would lose control that way, and he considered discounters low-life in general. What mattered were two things, quality, and knowing the customer: which was why, until a few weeks before his death, “Papa Jack” was always to be found from 8am till noon at his front desk in the company store on Wazee Street, poring over the past-due accounts and shaking hands with whoever came in, asking “Where you from?” and frequently being astounded at the answer.

Republican or not, globalisation was lost on him. He insisted that his shirts were manufactured in America. Sure, it cost more than getting them sewn in China; but if Chinese people made them, that would take jobs from Americans and mean they couldn’t buy his shirts anyway. When Reagan declared once that America had become a service economy, Mr Weil wrote to him complaining that “where I come from in southern Indiana, servicing meant when you took the mare to the stud.” Reagan gently pointed out to “Jack” that things were less simple in Washington.

Ungartered socks

Much as he loved them, Mr Weil had not begun in shirts. The farm boy had started off, at $25 a week, inspecting navy dungarees, and had moved on eventually to be a travelling rep for Paris Garters (“Not once, but many times”, the advert ran, “she had noticed his ungartered socks crumpling down around his shoe tops.”) His territory ran from the Mexican border to the Canadian. He supposed, diffidently, that he might need a car; though something better than the Model-T Ford he first drove, with wire wheels attached so loosely that if you backed up the street too far, they fell off.

He arrived in Denver in 1928 to find a rough-and-rumble cow-town of 200,000 people, famous mostly for the gold that had been discovered there. By his 107th year, as he noted with wonder, it was a city of 2m; and there was a Jack A. Weil Way in it, besides his own face looking down from the billboards of the Denver Visitors Bureau. And he, his grandson liked to say, had become the Henry Ford of the western look, snap-fasteners and all.

Overview

Aug 28th 2008
From The Economist print edition

There were tentative signs that America's **housing crash** may be bottoming out. Sales of newly built homes rose by 2.4% in July, although the levels of sales in May and June were also revised down. The stock of unsold new homes fell to 10.1 months of sales from 10.7 months in June. Sales of existing homes rose by 3.1% in July. The S&P/Case-Shiller national home-price index fell by 15.4% in the year to second quarter, a bit more than the 14.2% annual drop in the first quarter.

The omens for **America's** economy look a little less grim too. Orders for durable goods rose by 1.3% in July, building on a similar increase in June. The pick-up was led by demand for capital goods. The index of consumer confidence compiled by the Conference Board, a business-research group, rose to a three-month high in August.

The outlook for the **euro-area** economy, meanwhile, continues to darken. The index of German business sentiment published by Ifo, a Munich-based research firm, fell sharply in August. Orders for industrial goods in the euro area declined by a further 0.3% in June, after a 5.4% plunge in May.

In **Britain** the number of loans approved for house purchases was broadly flat in July, according to the British Bankers' Association, leaving them 65% lower than a year earlier.

Thailand's central bank raised its benchmark interest rate by a quarter of a percentage point, to 3.75%, the second increase in as many months.

Output, prices and jobs

Aug 28th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product latest	Gross domestic product qtr*	Gross domestic product 2008†	Gross domestic product 2009†	Industrial production latest	Consumer prices latest	Consumer prices year ago	Consumer prices 2008†	Unemployment rate‡, %
United States	+1.8 Q2	+1.9	+1.5	+1.2	–0.1 Jul	+5.6 Jul	+2.4	+4.4	5.7 Jul
Japan	+1.0 Q2	–2.4	+1.4	+1.2	nil Jun	+2.0 Jun	–0.2	+1.6	4.1 Jun
China	+10.1 Q2	na	+9.8	+9.0	+14.7 Jul	+6.3 Jul	+5.6	+6.6	9.5 2007
Britain	+1.4 Q2	+0.2	+1.4	+1.0	–1.6 Jun	+4.4 Jul§	+1.9	+3.6	5.4 Jun††
Canada	+1.7 Q1	–0.3	+1.2	+1.9	–4.6 May	+3.4 Jul	+2.2	+2.3	6.1 Jul
Euro area	+1.5 Q2	–0.8	+1.6	+1.2	–0.5 Jun	+4.0 Jul	+1.8	+3.6	7.3 Jun
Austria	+2.3 Q2	+1.6	+2.3	+1.7	–1.1 Jun	+3.8 Jul	+2.1	+2.9	4.1 Jun
Belgium	+2.0 Q2	+1.2	+1.6	+1.3	+1.5 May	+5.9 Jul	+1.4	+4.4	11.1 Jul‡‡
France	+1.1 Q2	–1.2	+1.5	+1.2	–1.6 Jun	+3.6 Jul	+1.1	+3.3	7.5 Jun
Germany	+1.7 Q2	–2.0	+2.0	+1.3	+1.6 Jun	+3.1 Aug	+2.2	+3.0	7.6 Aug
Greece	+3.4 Q2	+2.6	+2.8	+2.8	–3.4 Jun	+4.9 Jul	+2.5	+4.6	6.6 May
Italy	nil Q2	–1.1	+0.4	+0.7	–1.8 Jun	+4.1 Jul	+1.6	+3.6	6.5 Q1
Netherlands	+2.8 Q2	–0.2	+2.4	+1.6	+1.2 Jun	+3.2 Jul	+1.5	+2.5	3.9 Jul††
Spain	+1.8 Q2	+0.4	+1.6	+1.0	–9.0 Jun	+4.9 Aug	+2.2	+4.3	10.7 Jun
Czech Republic	+4.5 Q2	+3.6	+4.7	+5.4	+2.2 Jun	+6.9 Jul	+2.3	+6.6	5.3 Jul
Denmark	–0.7 Q1	–2.4	+1.0	+1.0	+0.3 Jun	+4.0 Jul	+1.2	+3.4	1.6 Jul
Hungary	+2.2 Q2	+2.4	+2.0	+3.3	–0.3 Jun	+6.7 Jul	+8.4	+6.5	7.5 Jul††
Norway	+5.9 Q2	+0.9	+2.5	+2.2	+5.9 Jun	+4.3 Jul	+0.4	+3.3	2.6 Jun***
Poland	+6.1 Q1	na	+5.4	+4.3	+5.6 Jul	+4.8 Jul	+2.3	+4.2	9.4 Jul‡‡
Russia	+8.5 Q1	na	+7.5	+6.8	+3.2 Jul	+14.7 Jul	+8.7	+14.0	5.3 Jul‡‡
Sweden	+0.7 Q2	–0.1	+1.9	+1.7	–1.5 Jun	+4.4 Jul	+1.9	+3.7	5.8 Jul††
Switzerland	+3.1 Q1	+1.3	+2.0	+1.4	+4.4 Q1	+3.1 Jul	+0.7	+2.7	2.6 Jun
Turkey	+6.6 Q1	na	+4.5	+4.3	+0.8 Jun	+12.1 Jul	+6.9	+11.0	8.9 Q2‡‡
Australia	+3.6 Q1	+2.5	+2.8	+2.7	+2.4 Q1	+4.5 Q2	+2.1	+4.0	4.3 Jul
Hong Kong	+4.2 Q2	–5.5	+4.7	+4.4	–4.4 Q1	+6.3 Jul	+1.5	+5.3	3.2 Jul††
India	+8.8 Q1	na	+7.7	+7.1	+5.4 Jun	+7.7 Jun	+5.7	+7.1	7.2 2007
Indonesia	+6.4 Q2	na	+5.8	+5.5	+3.3 Jun	+11.9 Jul	+5.3	+10.3	8.5 Feb
Malaysia	+7.1 Q1	na	+6.0	+5.6	+1.5 Jun	+8.5 Jul	+1.6	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+6.0	+4.4	+2.7 May	+24.3 Jul	+6.4	+18.6	5.6 2007
Singapore	+1.9 Q2	–6.6	+4.8	+4.9	–21.9 Jul	+6.5 Jul	+2.6	+6.0	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+6.7 Jun	+5.9 Jul	+2.5	+4.2	3.2 Jul
Taiwan	+4.3 Q2	na	+4.3	+4.4	+1.1 Jul	+5.9 Jul	–0.3	+3.4	3.9 Jul
Thailand	+5.3 Q2	+2.9	+4.8	+4.5	+11.2 Jun	+9.2 Jul	+1.7	+8.5	1.5 May
Argentina	+8.4 Q1	+2.4	+6.0	+4.0	+6.1 Jun	+9.1 Jul	+8.6	+9.7	8.0 Q2‡‡
Brazil‡	+5.8 Q1	+2.9	+4.6	+3.4	+6.6 Jun	+6.4 Jul	+3.7	+6.0	8.1 Jul‡‡
Chile	+4.3 Q2	+7.4	+3.6	+3.8	–0.9 Jun	+9.5 Jul	+3.8	+8.4	8.4 Jun††‡‡
Colombia	+4.1 Q1	–3.7	+4.5	+4.0	–6.6 Jun	+7.5 Jul	+5.8	+6.7	11.2 Jun‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	–0.5 Jun	+5.4 Jul	+4.1	+4.8	4.2 Jul‡‡
Venezuela	+7.1 Q2	na	+5.2	+3.0	–1.4 May	+33.7 Jul	+17.2	+30.6	7.5 Q2‡‡
Egypt	+7.5 Q1	na	+7.1	+6.7	+7.5 2007**	+22.0 Jul	+7.7	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.0	+3.2	+18.7 Jun	+4.8 Jul	+0.3	+4.3	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+6.7	na	+10.6 Jun	+3.4	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.2	+3.5	+6.1 Jun	+13.4 Jul	+7.0	+10.3	23.0 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	–1.4 Q2	+3.6	–0.6	+2.0	–4.7 Jun	+11.1 Jul	+6.4	+10.5	2.6 Jun
Finland	+3.1 Q1	+2.7	+2.8	+2.4	–3.3 Jun	+4.4 Jul	+2.6	+3.8	6.4 Jul
Iceland	+1.1 Q1	–14.0	nil	+0.8	+0.4 2007	+14.5 Aug	+3.4	+12.0	1.1 Jul‡‡
Ireland	–1.5 Q1	–0.9	–0.5	–0.1	+6.1 Jun	+4.4 Jul	+5.0	+4.0	5.9 Jul
Latvia	+3.3 Q1	na	–0.4	+0.5	–6.4 Jun	+16.6 Jul	+9.5	+15.8	5.7 Jun
Lithuania	+5.3 Q2	+4.5	+5.5	+4.8	na	+12.2 Jul	+5.1	+11.0	4.8 Jul‡‡
Luxembourg	+2.5 Q1	+5.3	+2.8	+2.6	+0.7 Jun	+4.9 Jul	+1.9	+4.0	4.0 Jun‡‡
New Zealand	+0.9 Q1	–2.3	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+11.5 Jun	na	+7.9	+6.6	+7.5 Jun	+5.8 Jul	+2.2	+5.3	7.4 Jun‡‡
Philippines	+4.6 Q2	+8.4	+4.7	+5.4	+4.7 May	+12.2 Jul	+2.6	+9.6	8.0 Q2‡‡
Portugal	+0.9 Q2	+1.4	+1.4	+1.3	–4.2 Jun	+3.1 Jul	+2.4	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.5	+5.2	+6.2 Jun	+4.9 Jul	+2.3	+4.2	7.5 Jul††
Slovenia	+5.4 Q1	na	+4.5	+4.0	+1.9 Jun	+6.9 Jul	+3.8	+6.0	6.4 Jun‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.– §RPI inflation rate 5.0% in July. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Aug 28th 2008
From The Economist print edition

The Economist commodity-price index

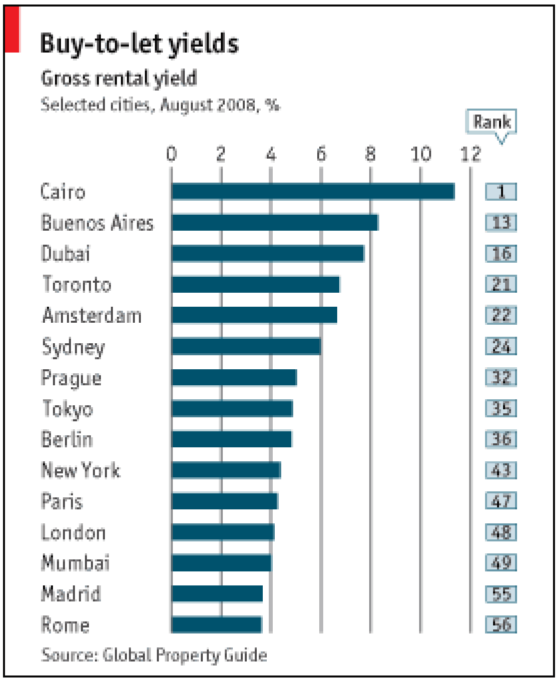
2000=100

	Aug 19th	Aug 26th*	% change on one month	% change on one year
Dollar index				
All items	238.1	251.5	+0.2	+25.6
Food	244.2	249.6	-1.3	+41.0
Industrials				
All	230.3	253.9	+2.2	+10.2
Nfa†	188.0	188.8	-5.7	+19.4
Metals	253.4	289.5	+5.3	+7.3
Sterling index				
All items	193.9	207.4	+8.0	+37.2
Euro index				
All items	149.8	158.7	+6.7	+16.9
Gold				
$ per oz	799.40	827.50	-9.9	+24.9
West Texas Intermediate				
$ per barrel	114.52	116.08	-5.0	+61.6

*Provisional †Non-food agriculturals.

Buy-to-let yields

Aug 28th 2008
From The Economist print edition



Investors looking to buy a property to let will receive the fattest yields in Cairo, according to the Global Property Guide. The study calculates rental yields for 59 cities around the world. In only four of the these (Panama City, Manila, Jakarta and Cairo) were gross yields in double digits. A low yield points to an overvalued housing market. Cities where house prices have risen much faster than rents—suggesting a property bubble—have some of the thinnest yields. Madrid's is a paltry 3.7% (Rome's, perhaps surprisingly, is lower still). Rents in London and Paris are barely above 4% of property values. Some of the best-valued property in the rich world is found in Toronto, where rental yields are not far below 7%.

Trade, exchange rates, budget balances and interest rates

Aug 28th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Aug 27th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−836.2 Jun	−710.7 Q1	−4.8	–	–	−2.4	2.06	3.75
Japan	+92.4 Jun	+207.3 Jun	+4.1	110	115	−2.8	0.75	1.45
China	+249.2 Jul	+371.8 2007	+8.6	6.84	7.55	0.5	4.32	4.80
Britain	−186.4 Jun	−102.4 Q1	−3.6	0.54	0.50	−3.8	5.73	4.50
Canada	+47.1 Jun	+14.5 Q1	+0.8	1.05	1.06	0.2	2.46	3.55
Euro area	+3.5 Jun	−31.5 Jun	−0.3	0.68	0.73	−0.9	4.96	4.18
Austria	+0.3 May	+14.8 Q1	+2.9	0.68	0.73	−0.6	4.96	4.36
Belgium	+9.5 May	−1.1 Mar	+1.1	0.68	0.73	−0.7	5.03	4.55
France	−70.2 Jun	−46.2 Jun	−1.5	0.68	0.73	−2.9	4.96	4.37
Germany	+286.2 Jun	+273.6 Jun	+6.4	0.68	0.73	1.1	4.96	4.18
Greece	−64.6 May	−49.9 Jun	−13.9	0.68	0.73	−2.6	4.96	4.89
Italy	−11.8 May	−67.6 Jun	−2.7	0.68	0.73	−2.6	4.96	4.82
Netherlands	+60.3 Jun	+50.7 Q1	+5.9	0.68	0.73	0.7	4.96	4.38
Spain	−153.4 Jun	−163.9 May	−9.4	0.68	0.73	−1.1	4.96	4.54
Czech Republic	+5.5 Jun	−5.0 Jun	−2.7	16.7	20.2	−1.8	3.65	4.42
Denmark	+4.5 Jun	+3.8 Jun	+1.0	5.07	5.46	3.8	5.70	4.43
Hungary	+0.8 Jun	−7.2 Q1	−5.9	160	189	−4.0	8.58	7.80
Norway	+77.1 Jul	+68.8 Q1	+17.3	5.38	5.84	17.7	6.54	4.81
Poland	−19.0 Jun	−22.6 Jun	−4.9	2.27	2.81	−1.9	6.27	6.05
Russia	+174.0 Jun	+109.8 Q2	+6.2	24.6	25.7	4.5	11.00	7.44
Sweden	+19.0 Jul	+40.4 Q1	+7.9	6.40	6.88	2.4	4.36	4.09
Switzerland	+16.5 Jul	+91.4 Q1	+13.9	1.10	1.20	0.9	2.74	2.90
Turkey	−72.1 Jun	−45.8 Jun	−6.4	1.19	1.32	−2.7	18.10	7.00‡
Australia	−18.4 Jun	−61.4 Q1	−5.6	1.17	1.22	1.4	7.19	5.71
Hong Kong	−25.6 Jul	+26.4 Q1	+9.0	7.81	7.80	3.0	2.25	2.94
India	−87.5 Jun	−17.5 Q1	−3.2	43.8	41.1	−3.4	9.12	9.56
Indonesia	+37.5 Jun	+10.9 Q1	+2.8	9,160	9,415	−2.0	9.88	7.24‡
Malaysia	+37.6 Jun	+30.6 Q1	+14.4	3.38	3.50	−3.1	3.70	4.46‡
Pakistan	−21.2 Jul	−10.5 Q1	−8.6	76.1	60.8	−6.4	13.04	13.95‡
Singapore	+26.3 Jul	+32.8 Q2	+19.4	1.42	1.52	1.0	1.19	2.95
South Korea	−1.6 Jul	+2.2 Jun	−2.5	1,084	942	1.5	5.79	5.95
Taiwan	+13.9 Jul	+32.6 Q2	+5.2	31.5	33.1	−1.8	2.75	2.51
Thailand	+7.8 Jun	+12.7 Jun	−0.4	34.1	34.3	−3.0	3.85	4.50
Argentina	+11.3 Jul	+7.9 Q1	+2.9	3.03	3.16	1.7	13.94	na
Brazil	+30.8 Jul	−19.5 Jul	−1.6	1.62	1.99	−1.6	12.92	6.16‡
Chile	+18.2 Jul	+1.0 Q2	−0.1	519	526	8.7	7.32	3.99‡
Colombia	+0.6 May	−5.0 Q1	−2.6	1,885	2,164	−1.0	9.89	5.87‡
Mexico	−8.2 Jul	−5.3 Q2	−0.8	10.1	11.1	−0.1	8.65	8.57
Venezuela	+41.9 Q2	+37.8 Q2	+12.1	3.70	4.23§	1.6	17.12	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.38	5.66	−7.1	12.12	5.19‡
Israel	−13.2 Jul	+4.4 Q1	+0.2	3.58	4.12	−1.0	4.15	5.39
Saudi Arabia	+150.8 2007	+95.0 2007	+36.9	3.75	3.75	22.3	4.13	na
South Africa	−10.3 Jun	−22.3 Q1	−8.0	7.76	7.24	0.4	12.15	9.27
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.2 Jun	−3.3 Jun	−10.8	10.6	11.5	−0.4	6.35	na
Finland	+12.2 May	+11.6 Jun	+4.5	0.68	0.73	4.5	4.90	4.35
Iceland	−1.2 Jul	−3.5 Q1	−14.6	82.7	64.1	2.0	15.97	na
Ireland	+38.2 Jun	−14.7 Q1	−3.5	0.68	0.73	−3.9	4.96	4.53
Latvia	−6.7 Jul	−6.0 Jun	−13.8	0.48	0.51	−1.5	5.88	na
Lithuania	−7.9 Jun	−6.0 Jun	−14.0	2.35	2.53	−0.7	5.76	na
Luxembourg	−6.6 May	+4.9 Q1	na	0.68	0.73	0.5	4.96	na
New Zealand	−3.3 Jul	−10.4 Q1	−7.1	1.43	1.43	1.2	7.60	6.03
Peru	+6.9 Jun	+0.8 Q1	−1.1	2.95	3.16	2.3	6.25	na
Philippines	−8.0 May	+5.6 Mar	+2.8	45.7	46.8	−0.8	4.56	na
Portugal	−24.2 May	−26.7 May	−9.0	0.68	0.73	−2.5	4.96	4.67
Slovakia	−0.9 Jun	−5.0 Apr	−4.7	20.6	24.8	−2.1	3.82	4.81
Slovenia	−3.9 Jun	−2.9 May	−5.8	0.68	0.73	0.1	4.96	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Aug 28th 2008
From The Economist print edition

Markets

	Index Aug 27th	% change on one week	Dec 31st 2007 in local currency	Dec 31st 2007 in $ terms
United States (DJIA)	11,502.5	+0.7	−13.3	−13.3
United States (S&P 500)	1,281.7	+0.6	−12.7	−12.7
United States (NAScomp)	2,382.5	−0.3	−10.2	−10.2
Japan (Nikkei 225)	12,753.0	−0.8	−16.7	−15.2
Japan (Topix)	1,223.7	−0.8	−17.1	−15.6
China (SSEA)	2,459.1	−7.2	−55.5	−52.4
China (SSEB, $ terms)	144.4	−11.3	−63.0	−60.5
Britain (FTSE 100)	5,528.2	+2.9	−14.4	−20.9
Canada (S&P TSX)	13,530.7	+1.4	−2.2	−7.8
Euro area (FTSE Euro 100)	1,029.4	+0.2	−25.1	−24.7
Euro area (DJ STOXX 50)	3,299.1	+0.1	−25.0	−24.6
Austria (ATX)	3,553.2	+1.7	−21.3	−20.8
Belgium (Bel 20)	3,033.7	+1.1	−26.5	−26.1
France (CAC 40)	4,373.1	+0.2	−22.1	−21.6
Germany (DAX)*	6,321.0	+0.1	−21.6	−21.2
Greece (Athex Comp)	3,244.0	−2.1	−37.4	−37.0
Italy (S&P/MIB)	27,958.0	−0.7	−27.5	−27.1
Netherlands (AEX)	406.1	+0.9	−21.3	−20.8
Spain (Madrid SE)	1,232.0	+0.7	−25.0	−24.5
Czech Republic (PX)	1,444.0	+0.3	−20.4	−13.4
Denmark (OMXCB)	388.3	+1.5	−13.5	−13.0
Hungary (BUX)	20,200.5	−0.5	−23.0	−17.0
Norway (OSEAX)	486.4	+2.4	−14.7	−13.8
Poland (WIG)	39,468.2	−1.1	−29.1	−23.1
Russia (RTS, $ terms)	1,589.1	−7.3	−30.4	−30.6
Sweden (Aff.Gen)	267.7	+1.7	−21.4	−20.5
Switzerland (SMI)	7,086.6	−0.2	−16.5	−14.0
Turkey (ISE)	39,576.0	−0.6	−28.7	−29.8
Australia (All Ord.)	5,087.8	+1.8	−20.8	−22.3
Hong Kong (Hang Seng)	21,464.7	+2.5	−22.8	−22.9
India (BSE)	14,296.8	−2.6	−29.5	−36.5
Indonesia (JSX)	2,131.1	+3.0	−22.4	−20.4
Malaysia (KLSE)	1,067.7	−0.5	−26.1	−27.7
Pakistan (KSE)	9,144.9	−13.1	−35.0	−47.4
Singapore (STI)	2,705.1	−1.7	−21.9	−20.8
South Korea (KOSPI)	1,493.9	−3.0	−21.3	−32.0
Taiwan (TWI)	7,081.0	+0.6	−16.8	−14.2
Thailand (SET)	676.0	−2.0	−21.2	−22.1
Argentina (MERV)	1,779.7	+2.3	−17.3	−13.9
Brazil (BVSP)	55,519.0	+0.3	−13.1	−4.7
Chile (IGPA)	13,785.9	+2.5	−2.1	−6.1
Colombia (IGBC)	9,052.3	+0.9	−15.4	−9.4
Mexico (IPC)	26,131.4	−2.7	−11.5	−4.8
Venezuela (IBC)	39,828.6	−0.3	+5.1	−32.2
Egypt (Case 30)	8,203.7	+5.2	−21.6	−19.6
Israel (TA-100)	934.2	−0.8	−19.1	−12.9
Saudi Arabia (Tadawul)	8,899.0	+5.1	−19.4	−19.4
South Africa (JSE AS)	27,426.6	+2.4	−5.3	−16.6
Europe (FTSEurofirst 300)	1,173.6	+0.7	−22.1	−21.6
World, dev'd (MSCI)	1,330.4	+0.6	−16.3	−16.3
Emerging markets (MSCI)	953.7	−0.8	−23.4	−23.4
World, all (MSCI)	334.3	+0.4	−17.1	−17.1
World bonds (Citigroup)	750.2	−0.1	+2.7	+2.7
EMBI+ (JPMorgan)	438.8	+0.1	+1.2	+1.2
Hedge funds (HFRX)	1,259.4	nil	−5.3	−5.3
Volatility, US (VIX)	19.8	20.4	22.5	(levels)
CDSs, Eur (iTRAXX)†	102.2	+4.1	+102.0	+103.2
CDSs, N Am (CDX)†	154.4	+0.7	+98.2	+98.2
Carbon trading (EU ETS) €	25.2	+2.7	+13.1	+13.8

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Exchange rates against the dollar

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On April 22nd the dollar briefly traded at $1.60 against the euro. That proved to be the low point for the greenback, which has staged a dramatic rally in recent weeks. Its gains against the main European currencies—the euro, the pound, the Swedish krona and Swiss franc—have been broadly similar. It has advanced less quickly against some Asian currencies (the South Korean won is an exception); indeed, it has lost ground against China's currency. One fading star is the Australian dollar. Its fate is partly tied to falling commodity prices, which have helped lift the dollar. But its decline also reflects a shift in policy by the central bank, which has hinted that the next move in Australian interest rates is down.